In the Supreme Court of the United States.

October Term, 1913.

Stratton's Independence, Limited,
v.
F. W. Howbert, Collector of Internal Revenue within and for the District of Colorado. } No. 457.

ON A CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

SUPPLEMENTAL BRIEF FOR F. W. HOWBERT, COLLECTOR, IN REPLY TO QUESTIONS RAISED BY MR. GUTHRIE'S BRIEF.

I.

THE PENNSYLVANIA CASES.

1. Mr. Guthrie apparently argues (pp. 7, 8) that the Pennsylvania cases can be distinguished because the Pennsylvania act expressly mentioned mining and quarrying companies. This, however, is just as true of the Corporation Tax Act, as pointed out in the Government's brief, since that act includes *all corporations* and does not *exempt* mining corporations.

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It is, therefore, no different than if the Corporation Tax Act had included mining corporations *eo nomine*. Moreover, the Supreme Court has decided that mining companies are included in the act in the cases referred to on pages 2 and 3 of the Government's brief.

2. Mr. Guthrie claims that the Pennsylvania cases are also distinguishable because of the peculiar language of that act in levying a tax upon the "net earnings or income" of those corporations "not paying a tax to the State upon dividends under existing laws." Mr. Guthrie's argument here is rather peculiar. He first contends that since mining companies are allowed to pay dividends and since such dividends must be paid out of capital the term "dividends" may refer to a mere division of capital, and does so refer where it is used in connection with mining companies; but this is to beg the whole question. It is a much sounder view to take that dividends by mining companies are permitted because they are not dividends of capital, but are dividends of income. In other words, where the mining companies do not choose to allow their capital to remain stagnant, but voluntarily convert it into another form and distribute it as dividends, the companies have voluntarily changed their capital into income, and the law must so regard it. Therefore Mr. Morawets says in his citation, given on page 6 of the Government's brief:

> * * * It is implied from the character of the speculation of a mining company, that

> the *income derived from working the mine* shall be distributed among the shareholders as dividends, after deducting the expenses, and making reasonable provision for contingencies.

And in the case of *Excelsior Water & Mining Co. v. Pierce*, cited on page 7 of the Government's brief, the California statute expressly forbade the payment of dividends out of capital, and the court could only have reached its conclusion, conforming to the statute, by holding that the dividends in question were not paid out of capital but out of income.

Having established, as he claims, that dividends of mining companies are paid out of capital, he argues that the Pennsylvania income tax act only intended to equalize taxation upon dividends, and that therefore the words "net earnings or income," must be read in connection with the provision as to a tax upon dividends, and that, when so read, the words "net earnings or income," refer to divisions of capital as well as to divisions of income. This certainly is peculiar reasoning. The common sense view would be just the contrary, namely, that the Pennsylvania Legislature thought, as every one else thinks, that dividends are paid out of income, and that therefore the words "net earnings or income" meant exactly what they said, and nothing else. However that may be, the Pennsylvania act is clearly an act taxing net incomes. It can not be pretended to be anything else, and the Supreme Court of the State in the two cases cited made no reference to the provision of the act as to dividends, but decided squarely

that the receipts of a mining company from sales of its ore were net income, within the meaning of the act.

Mr. Guthrie states on page 8 of his brief as follows:

> The Pennsylvania statute, however, is essentially different from the Federal Corporation Tax Law. The Federal statute is not concerned with "net earnings" and contains no language indicating that the "net income" which measures the tax is to be regarded as being the same fund which provides dividends for the shareholders.

This seems to be a clear misstatement of the Corporation Tax Act. That act expressly provides that from the "*gross income*" of the corporations concerned there shall be deducted "all amounts received by it within the year *as dividends upon stock of other corporations*, * * * subject to the tax hereby imposed." Here is a clear recognition by Congress that dividends are payable out of net income, and they are permitted to be deducted, so that the same net income may not be doubly taxed.

II.

THE ENGLISH CASES.

1. Mr. Guthrie says, on page 10 of his brief, that it is sometimes asserted that the modern English income tax act is a tax on income but on nothing else, and that a dictum to that effect may be found in Lord Macnaghten's opinion in the case of *London County Council v. Attorney General*. This statement Mr. Guthrie says is inaccurate.

In the first place, it is not clear that Lord Macnaghten's statement was a dictum at all. It appears to have been necessary for the decision to lay down a principle of that character. However that may be, Lord Davey, who rendered the only other considered judgment, said of the term "income tax" the following (1901 A. C., pp. 44, 45):

> * * * And, not to weary your Lordships, the words may be found in all the subsequent Acts (which have been passed almost yearly) as describing the tax which is levied under all the five schedules without distinction. In this Act of 1888, s. 24 is one of a group of sections collected under the heading of "income tax." By s. 23 it is enacted that there shall be charged, collected, and paid the following duties of income tax under all the five schedules. I come to the conclusion that the expression "income tax," in the language of the Legislature, is a generic description of the tax which is levied under all the schedules alike, and is so used in s. 24.

Lord Brampton and Lord Robertson merely stated that they had read the opinions of Lords Macnaghten and Davey and coincided exactly with the conclusions reached therein.

Moreover, in *Secretary of State v. Scoble* (1903 A. C., 299) the point was squarely decided. On page 302 the Lord Chancellor said:

> That introduces this consideration: was it the intention of the income tax acts ever to tax capital as if it was income? I think it

> can not be doubted, upon the language and the whole purport and meaning of the income tax acts, that it never was intended to tax capital—as income at all events.

To the same effect are the remarks of Farwell, L. J., in *Stevens* v. *Hudson Bay Co.*, quoted on page 5 of the Government's brief. The language of Farwell, L. J., immediately preceding the quotation in the Government's brief, is as follows:

> It is well settled that income, not capital, is taxable under the income tax acts and that income is so taxable notwithstanding that on an adjustment of accounts part of the sums accruing as income ought to recoup capital.

Mr. Guthrie's argument to the contrary seems based upon the provisions of the income tax acts to the effect that no deduction should be allowed on account of any capital withdrawn, etc. This, however, evidently throws no light upon the question as to whether the corporation has an income or not to begin with, so as to bring it within the act at all, but only deals with the matters of deduction from the gross income. I shall consider this point more fully further along.

2. Mr. Guthrie claims that the English cases holding that a mining company may not deduct from its gross income the value of the ore mined during the year depend entirely upon rule 3 of the first case under schedule D of the income tax act, which prohibits any deduction on account of capital withdrawn, or for any sum employed or intended to be

employed as capital, or (sec. 159) on account of diminution of capital.

This is entirely incorrect as to the case of the *Coltness Iron Company* v. *Black*, cited on page 9 of the Government's brief.

Schedule A of the income tax act of 1842 levied a tax upon all lands, tenements, and hereditaments in Great Britain, "in respect of the property thereof, for every twenty shillings of the annual value thereof, the sum of seven pence."

Rule No. 3 of schedule A provided as follows:

> The annual value of all the properties hereinafter described shall be understood to be the full amount for one year, or the average amount for one year, *of the profits received therefrom* within the respective times herein limited.

Mines in Great Britain come under schedule A of the act of 1842, and the original act had no provision as to schedule A prohibiting a deduction on account of diminution of capital. That provision was attached to schedule D, which was a catchall schedule and was levied upon "the profits or gains" of a trade, manufactory, etc.

Section 8 of the act of 29 and 30 Vict., c. 36, provided that the concerns described in rule No. 3 of schedule A of the act of 1842 (which class included mining companies) should be charged and assessed according to the rules prescribed by schedule D of the said act, so far as the rules were consistent with rule

No. 3 of schedule A of the act of 1842. In *Knowles* v. *McAdam*, L. R. (3 Ex. Div., 23), the Court of Exchequer held that the effect of section 8 of the act of 29 and 30 Vict., c. 36, was to subject concerns in schedule A to all the provisions of the rules applicable to schedule D, including the rule as to diminution of capital; but the court held that before a mining company had any profits at all under schedule A, it must charge off the depreciation of its capital, and that the prohibition as to deducting any diminution of capital had no application to such a case, but referred only to cases where capital was withdrawn from a concern, or the like.

In *Coltness Iron Co.* v. *Black*, where *Knowles* v. *McAdam* was overruled, both Lord Cairns and Lord Blackburn expressly held that the decision of the Court of Exchequer, to the effect that mining companies were subject to the provision as to diminution of capital contained in schedule D, was wrong, and that the taxes upon those companies must be estimated in this respect under the rules applicable to schedule A, and they made the same remarks as to the decision of the Scotch court in *Addie* v. *The Solicitor of Inland Revenue*, relied upon on page 11 of Mr. Guthrie's brief. As to that Lord Blackburn said (p. 337):

> * * * And I see that in *Addie* v. *The Solicitor of Inland Revenue* reliance is placed in the judgment of the Lord President on the third rule as to concerns under the first case of schedule D, that no deduction is to be made

"for any sums employed or intended to be employed as capital." But I do not think reliance can be placed on this. If, from the nature of the concerns in number three, an allowance ought to be made for capital, then this rule should be rejected as inconsistent with number three. If no such allowance should be made, the rule is not required.

The decision of the House of Lords, therefore, went squarely upon the point that it followed from the nature of mining companies as taxed on their profits under schedule A of the act of 1842, that they could not make a deduction for the depletion of their capital.

In Lord Penzance's judgment (pp. 325 to 327), no mention at all is made of the provision prohibiting a deduction of capital, but the whole judgment goes upon the general theory that a depletion of capital can not be taken into consideration in estimating what the profits of a concern are.

As to the case of *Alianza Company* v. *Bell*, referred to in the Government's brief on page 13, it is perfectly true, as Mr. Guthrie states, that the decision turned largely, if not wholly, upon the provisions of the rules applicable to schedule D prohibiting any deduction of capital. But the Federal Corporation Tax Act is just the same in this respect as the English income tax act, as argued in the Government's brief (pp. 10 to 13), and therefore the decisions in the case of *Alianza Company* v. *Bell* are of weight. The Federal Corporation Tax Act does not permit the deduction

from gross income of capital expenditures. The clause where such a deduction would have appeared, if it were permitted, is the first, namely:

> "All the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property;".

Evidently no deduction of capital could be included under this item, which is just as specific upon this point as the language of the English income-tax act prohibiting in terms such a deduction. When a merchant purchases a stock of goods, or when a manufacturer purchases raw material, those items are legitimately charged up to expense, and will be so carried on the books of such a merchant or manufacturer. They could therefore be deducted under the first item of deductions. But payments made by a mining company for its land and ore are capital payments, would be so carried on the books, and could not be deducted as expense under item 1. As well said by Channell, J., in *Alianza Company* v. *Bell* (1904 Sec. K. B., 673):

> I find nothing in the rules to say that if the business to be assessed is that of manufacturing an article and selling it, and nothing more, the cost price of the material consumed in the manufacture is not to be taken into account in assessing the profits. In the ordinary case, the cost of the material

> worked up in a manufactory is *not a capital expenditure;* it is a current expenditure, and does not become a capital expenditure merely because the material is provided by something like a forward contract under which a person for the payment of a lump sum down secures a supply of the raw material for a period extending over several years.

But of a mining company he says:

> The money paid for the prime cost of the stuff so dealt with is just as much capital as the money sunk in machinery or buildings.

Since the Corporation Tax Act merely permits the *deduction of expenses*, the *deduction of capital expenditures* is impliedly prohibited, unless it can be brought within the item permitting a deduction of depreciation; and that it can not be included in that item is fully argued in the Government's brief.

SAM'L J. GRAHAM,
Assistant Attorney General.

OCTOBER, 1913.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1913.

No. 457.

STRATTON'S INDEPENDENCE, LIMITED,

vs.

F. W. HOWBERT, COLLECTOR OF INTERNAL REVENUE WITHIN AND FOR THE DISTRICT OF COLORADO.

ON A CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

REPLY FOR STRATTON'S INDEPENDENCE, LIMITED.

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REPLY FOR STRATTON'S INDEPENDENCE, LIMITED.

We submit the following in reply to the Government's points, in the order in which they are presented:

I.

The fifteen cases covered by the decision in 220 U. S., 107, were all directed to the question whether the corporation tax was constitutional. Of the two cases involved therein, and referred to by the Government under its Point I, only

the case of Mitchell *vs.* Clark Iron Company is mentioned in the opinion. The briefs in that case do not discuss the questions which we have presented in connection with the argument under the first certified question. The reason for the failure to discuss such questions was doubtless due to the fact that the paramount question in the case was the constitutional one.

There is a real and wide distinction between a corporation receiving rental for its mines, such as Clark Iron Company, and a corporation mining its own premises, such as Stratton's Independence, Limited.

We submit that there are peculiar reasons arising from the manner in which the *Clark Iron Company* case was submitted, concurrently with so many other important cases, in all of which the constitutional question was the paramount issue, which should lead the court to reconsider the language used with reference to the *Clark Iron Company* case, if it be of opinion that that language, if considered final, concludes our argument in this case.

We further submit that the *McCoach* case illuminates and qualifies the language of the *Flint* case.

II.

The record in the *Baltic Mining Company* case was not essentially different from the record in the other fourteen cases involved in the *Flint* case. It is true that in the briefs in that case, out of over one hundred pages of matter, nine lines were devoted by eminent counsel to a proposition akin to, if not identical with, one of our contentions in this case. No reference is made to that contention in the opinion. It may well be that the record did not call for a consideration of the contention in view of the course taken by the argument.

The Baltic Mining Company appears on its record as a smelting and a manufacturing company, and no attempt

was made on the record to segregate the proceeds of its mining operations from the income from its other activities.

The definition from Waring *vs.* Mayor, etc., 60 Ga., 93, might be accepted by us as a more or less correct definition of income, but the Government's application of the definition is fallacious. Ore is in no sense the fruit of the mine. The miner cuts down his tree.

If the Government's argument, based on Professor Fisher's definition, which is found on page 4 of the Government's brief, is to the effect that by the sale of the ore and the diversion of the proceeds into other channels of use, that which was capital before the diversion must be treated as income after the diversion, the theory is directly answered by the case of Gray *vs.* Darlington, 15 Wall., 63, and Stevens *vs.* Hudson's Bay Co., 101 Law Times, 96.

The Government states that, according "to the usage of business men" and "to the understanding of business men," the term "income" embraces within its meaning proceeds in mining operations. We take issue with these statements, and assert that neither the usage nor understanding of men engaged in legitimate mining industry recognizes that the term "income" includes the proceeds of mining operations, but, on the contrary, they understand that such proceeds are in fact return of capital resulting from depletion of the property.

The Government cites Morawetz on Private Corporations (2d ed.), section 442; Lee *vs.* Neuchatel Asphalte Company, 41 Ch. Div., 1, and Excelsior Water & Mining Co. *vs.* Pierce, 90 Cal., 131, 27 Pac., 44, wherein the principle is announced that the net proceeds of mining operations realized by a mining corporation may be distributed as dividends to the shareholders. These authorities do not hold that the proceeds of mining operations are not capital. The California case uses language which designates such proceeds as "profits." An analysis of the cases cited shows that they have no bearing on the question before this court. They do not even give a judicial meaning to the term "profits." A defi-

nition of the word "profits" is not a definition of the word "income."

The case of Lee *vs.* Neuchatel Asphalte Company is the leading case in this line of decisions, and clearly states the *rationale* of the doctrine. There is nothing inherently wrong in the distribution of capital if the corporation is organized for the purpose of realizing and distributing capital. During the argument in that case, Lopes, L. J., remarked:

> "All the shareholders knew it was a wasting property."

And in his opinion, Cotton, L. J., said (page 17):

> "There is nothing in the act which says that dividends are only to be paid out of the profits. * * * If this property was property of another nature—property which would not be reasonably or properly consumed in providing profit, the case would stand in a very different position. If there was a permanent property which would not be reasonably or properly so consumed, but the fruit of which only would be used in providing profit, then if the directors were to sell, or the shareholders were to authorize a sale of that, and then to declare a dividend out of the proceeds, that would clearly come within the case of Guinness *vs.* Land Corporation of Ireland (22 Ch. D., 349), for it would be applying the capital of the company to a purpose which was not authorized. *But here, for the purpose of getting the profit, there is necessarily a consumption year by year of part of the capital of the company.*" (Italics ours.)

The *Excelsior* case cites the *Neuchatel* case. The contention in the *Excelsior* case was not that the proceeds of mining operations could not be distributed as dividends. The right so to do was recognized on the authority of the *Neuchatel* case. The controversy was over a misapplication of the net proceeds of mining operations and the payment of dividends, in claimed disregard of the obligation of the corporation to certain creditors.

The *Excelsior* case might well be used by us in support of the first subdivision of our argument under the first question, for notwithstanding the broad terms of the California act which prohibited the declaration of dividends by *any corporation* out of capital, it was admitted, without serious argument, that the act had no application to a mining corporation which was formed for the very purpose of realizing and distributing its capital.

The Government also cites a number of life-tenant cases, of which the case of Daly *vs.* Beckett, 24 Beav., 114, is a type. These cases, considered in their proper setting, emphasize our contention. At common law a life-tenant of property was not entitled to the proceeds of mining operations for the simple reason that they were not income. Such proceeds were required to be invested, and only the income on the money so invested belonged to the life-tenant. This was true wherever the life-tenancy was created by law, such as tenancy by curtesy or dower. Wherever the life-tenancy was created by will, or instruments between the parties, the courts would seize upon the slightest language to give to the life-tenant the right to enjoy the net proceeds of the mines if they were already opened. And if the clear intent to permit the life-tenant to enjoy not only mines already opened, but mines that might be opened, could be found in the instrument, the right so to do would be upheld by the court.

All of the Government's cases are cases involving the construction of wills or of instruments giving a life estate in property containing mines.

In Raynolds *vs.* Hanna, 55 Fed., 783, one of the cases cited with Daly *vs.* Beckett, the royalties claimed by the life-tenant were in fact flat rental, because the mines were not being operated, and the court refused to call such rental a part of the corpus of the estate merely because the mines might subsequently be worked and the rentals accrue in the form of a royalty on materials extracted.

The Government uses two Pennsylvania cases which hold that the Pennsylvania income tax of 1864 (Pamph. Laws,

Pa., 1864, page 218) applies to the proceeds of oil and coal operations (Commonwealth *vs.* The Ocean Oil Co., 59 Pa. St., 61; Commonwealth *vs.* Penn. Gas Coal Co., 62 Pa. St., 241).

The act there in question, in section 2 thereof, refers specifically to mining companies, and the tax is assessed on "amount of *net earnings* or income." There was no constitutional limitation on the powers of the legislature of Pennsylvania in the passage of the act. The point that the proceeds of such operations were not income was not raised, but the question in these cases was whether there could be any net earnings before the nominal capital of the companies had been written off. Both opinions are by the same judge, and it was held by the court that the proceeds of such operations were taxable under the act, but whether as "income" or as "net earnings" does not appear. The court denied the contention that the nominal capital should be written off before there was anything upon which to levy the tax.

In the first of these cases the court laid stress upon the fact that dividends were being declared by the company out of the proceeds of the oil operations. It did not consider the fact that such dividends are properly payable because that is the intent of the incorporators, and not because such proceeds are properly classified as "earnings," or "profits," or any other thing different than "capital."

The Government further cites the case of Coltness Iron Company *vs.* Black, 6 App. Cas., 315. This case arose under 5 and 6 Vict., C. 35 (1842), as amended by 16 and 17 Vict., C. 34 (1853). Parliament is not circumscribed by any constitutional limitations limiting direct taxes, and the acts in question provide for both property taxes and income taxes. The exact question in the *Coltness* case was whether a part of the expenses of producing coal, to-wit, the sinking of pits, could be apportioned to the expenses of mining for a certain year, before determining the net proceeds of certain coal mines for that given year (a deduction allowed by section

38 of the act before this court). The deduction was not allowed, but the reason is fully set forth in the opinion of Lord Penzance, on pages 325-326:

> "The intention of the act, it is abundantly clear, was in Schedule A to tax 'property.' * * * The words 'profits received therefrom' are here introduced to define the annual value of the thing which is to be taxed, which is the 'mine,' and it could not, I think, be intended that for the purpose of calculating the 'annual value' of a 'mine,' the original cost of the 'mine' itself, or any part of it, should be first deducted."

And again on page 327:

> "And the words 'annual value' or 'profit' received from that 'property' are introduced into the statute not as the subject of taxation, but only as the measure of the taxation to which the 'property' shall be subjected."

The House of Lords also considered section 159 of the act, which contains express prohibitions against such deductions as were asserted.

This case expressly places the taxation of mining properties on the property tax basis.

The quotation on page 5, from Stevens *vs.* Hudson's Bay Co., *supra*, is a statement used *arguendo* by Farwell, L. J., evidently without a careful reading of the grounds upon which the leading English case was decided. A perusal of the opinion of Justice Farwell discloses the fact that the quoted statement has no logical connection with the discussion in which he was engaged in that case, which in terms sustains the contentions of the plaintiff in error in the case now before this court.

III.

The word "depreciation" in the mining industry has an ordinary meaning and usage. That meaning is exactly the meaning which we give to the term here, to-wit, depletion of ore reserves. In no sense is depreciation "loss." Congress does not so construe it; otherwise it would not have used the word "depreciation" after providing for the deduction of "loss." Capital used in industry may find its way into the proceeds of the industry, and in order that it may not be considered income or profits, it is determined and restored to the capital account.

If the proceeds are not sufficient to make due restoration, then depreciation may amount to a loss; but so long as its equivalent can be found in the proceeds, there has been no loss. If the proceeds of mining operations are treated as capital and not as income, there is no depreciation of the capital of the company. If, however, such proceeds are segregated from the capital and treated as income, that which is income's gain is capital's depletion.

The Government cites the case of the Alianza Company *vs.* Bell, 1906 A. C., 18. This case is decided on section 100, rule 3, of 5 and 6 Vict., C. 35:

> "In estimating the balance of profits and gains chargeable under Schedule (D), or for the purpose of assessing the duty thereon, no sum shall be set against or deducted from, or allowed to be set against or deducted from, such profits or gains * * * on account of any capital withdrawn therefrom;"

and upon section 159 of the same act, which provides:

> "And be it enacted that in the computation of duty to be made under this act in any of the cases before mentioned * * * it shall not be lawful to make any other deductions therefrom than such as are expressly enumerated in this act, nor to make any deduction * * * on account of diminution of cap-

> ital employed or of loss sustained in any trade, manufacture, adventure, or concern, or in any profession, employment, or vocation."

The differences between the English act and the act here in question are that the English act measures the tax by "profits or gains," and prohibits any deduction for depreciation, while section 38 measures the tax by income and directs such deduction to be made.

IV.

In United States *vs.* Nipissing Mines Company, 202 Fed., 803, Judge Lacombe held that the practice of any corporation in writing off depreciation, or failing to write it off, was immaterial to the question whether certain depreciation should be allowed.

In the *Alianza* case (1905), 1 K. B., 184, at 193, the court said:

> "The question in these cases is not whether the deduction might be made in a theoretically perfect balance sheet, but whether it is a deduction permitted by the act."

A corporation formed for the purpose of converting and realizing upon its mining properties cannot be prejudiced in its claim for depreciation, if there be such depreciation in fact, simply because it carries out the purpose of its incorporation and distributes its realized proceeds by way of dividends. Every stockholder familiar with the business knows that such dividends necessarily represent depletion of the property. The question is not one of bookkeeping, but one of substance.

Prof. Fisher's distinction between "ideal" earned income and "realized" income seems to have been recognized by Congress, at least to the extent that by directing deductions for depreciation of capital it recognized the "ideal" income as the basis upon which the tax should be computed, rather

than that which some economists might designate "actual" income. The difficulty with Prof. Fisher's definition is that it fails to credit the business man of ordinary experience with sufficient power of discrimination to observe the element of depreciation which is always present in the corporation's receipts.

Respectfully submitted,

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Brief for Stratton's Independence, Limited.

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BRIEF IN BEHALF OF STRATTON'S INDEPENDENCE, LIMITED.

This cause is before this court upon the certification thereto of three questions, to-wit:

First: Does Section 38 of the Act of Congress entitled "An Act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes," approved August 5th, 1909, 36 Stat., p. 11, apply to mining corporations?

Second: Are the proceeds of ores mined by a corporation from its own premises income within the meaning of the aforementioned Act of Congress?

Third: If the proceeds of ore sales are to be treated as income, is such a corporation entitled to deduct the value of such ore in place

> and before it is mined as depreciation within the meaning of Section 38 of said Act of Congress?

It is difficult to avoid, in a discussion of these questions, consideration of the peculiar rules, and the seemingly arbitrary interpretation of the Act, announced by the commissioner of internal revenue, and applied in the collection of the corporation excise tax.

It is submitted that the first and second questions certified by the Circuit Court of Appeals should be answered in the negative, and that the third question should be answered in the affirmative. Such answers seem to be required by principle, and would be in line with decisions which have been filed by various federal courts construing Section 38 of the Act of August 5, 1909.

So far as we are advised, there have been seven decisions by the federal courts which have a direct bearing on the questions now before this tribunal. Those decisions were rendered in the following cases:

Flint v. Stone-Tracy Co., 220 U. S. 107.

Zonne v. Minneapolis Syndicate, 220 U. S. 187.

United States v. Nipissing Mines Co., 202 Fed. 803.

Same case on appeal, decided in Circuit Court of Appeals for the Second Circuit in June, 1913, and still unreported.

McCoach, collector, v. Minehill, etc., R. R. Co., 228 U. S. 295.

Sargent Land Company v. von Baumbach, collector, United States District Court, Minnesota, decided by Willard, J., and not yet reported.

Stratton's Independence, Limited, v. Howbert, collector, not reported.

The correctness of the last named decision is immediately involved here.

The decisions in the cases referred to were briefly as follows:

1. *The Flint case.*

There the attention of this court was principally addressed to the question of the constitutionality of the Act. The decision established, *first*, that no tax is imposed by the Act upon any corporation *solely because of its ownership of property*, and that the tax is not one upon incomes or a direct tax upon corporate franchises or other property; *second*, that the tax may be described generally as one upon the doing of business in a corporate capacity; *third*, that no tax is payable under the terms of the Act irrespective of the use of the corporate franchises in business, but that, if business is not done in the manner described in the statute, no tax is payable; *fourth*, that the Act is, therefore, constitutional and valid.

2. *The Zonne case.*

In that case the Minneapolis Syndicate, a corporation, being the owner of a tract of land upon which it had constructed an office building, sold

the building to certain individuals acting as trustees, and, at the same time, leased to them the land for a period of 130 years. The corporation had no other property, and, after the execution of the lease, amended its articles of incorporation so as to provide that "the sole purpose of the corporation shall "be to hold the title to the westerly half of block "eighty seven of the town of Minneapolis, now vest-"ed in the corporation, subject to a lease thereof "for a term of 130 years from January 1, 1907, and, "for the convenience of its stockholders, to receive "and to distribute among them, from time to time, "the rentals that accrue under said lease and the "proceeds of any disposition of said land." Thenceforward, the corporation performed no other function than to receive the rentals accruing under the lease and to distribute them among its stockholders.

This court determined that, with the sale and lease mentioned, the corporation had practically gone out of business in connection with its property, and thereafter was not engaged in doing business within the meaning of the Act. Its receipt and distribution of the rentals—although the corporate organization was expressly continued for that purpose—was not the carrying on of business in such wise as to subject it to the corporation tax. The court also declared that the corporation had, by its reorganization, *disqualified itself from any activity* in respect of its property.

3. *The Nipissing Mines case.*

The Nipissing Mines Company is the owner of all the capital shares of the Nipissing Mining Company, a Canadian corporation engaged in operating certain silver mines in the Province of Ontario, of which it has been the owner since some time prior to 1906. Said shares of stock constitute the entire substantial assets of the Mines Company. The receipts of the operating company applicable to that purpose are declared as dividends and paid to the Mines Company from time to time, and are distributed by the latter to its stockholders.

Upon the requirement of the commissioner of internal revenue, the Mines Company paid, under protest, an excise tax for the year 1909, assessed pursuant to the Act of August 5th.

Such tax was based upon a return made by the Mines Company in which a large deduction for depreciation was made. Subsequently, the commissioner conceived that such deduction was incorrect, and he compelled the making of a second return, formulated in accordance with certain rules promulgated by him, upon which an additional tax of \$8,534.68 was demanded. Payment thereof being refused, the action was brought in the name of the United States for its recovery. The defendant, denying any liability whatever, sought by counter-claim to recover the amount originally paid by it. The case was tried before *Judge Lacombe*, who directed a verdict dismissing the complaint and in favor of the Mines Company for the amount of its counter-claim.

The decision of *Judge Lacombe* was based upon the sole ground that the assets of the Mines Company (consisting solely of the capital stock of the Mining Company) were depreciated in value by an amount equal to the value in place of the ore which had been removed from the mining property during the tax year of 1909. This value was shown to be 31.1 cents per ounce of silver. *Judge Lacombe* said:

> "Certainly so much value has been eliminated from the property of the company forever. Granting the proposition that such is a reasonable allowance for depreciation, upon the figures here there is no net profit remaining. * * *
>
> "If the known value of an ore bed were exactly $2,000,000, and exactly $500,000 were taken out of it each year, in four years there would be nothing left. It is difficult to say why it may not reasonably be said that the ore bed suffers each year a depreciation of $500,000, just as a $10,000 piece of machinery with a life of ten years, suffers a depreciation of $1,000 each year. As I read the statute, Congress intended to allow all reasonable depreciations to be deducted from the gross profits to find the net; and the reasonableness of any deduction asked for depends upon the nature of the claim on which it is based, not upon the amount of dollars it may aggregate. Nor is it apparent why it should make any difference that one cannot tell with reasonable certainty the total value of the deposit, so long as the value of the amount removed in any one year can be ascertained with sufficient accuracy. Nor is it apparent why the problem is altered in any way by the circumstance that the property was bought at a very high or at a very low price, or that the capitalization of the company which owns it is large or small."

4. *The Nipissing Mines Company case, on appeal.*

By writ of error, the United States removed the case to the Circuit Court of Appeals of the Second Circuit, where it was argued and a decision rendered in June, 1913, which has not yet been reported.

The judgment of the court below was reversed, *in so far as it directed recovery against the United States on the counter-claim*, because the Revised Statutes do not authorize the recovery of demands against the government upon counter-claims.

The judgment denying a right of recovery by the United States was affirmed, however, but upon the ground that the *Mines Company was not a corporation "doing business,"* the court saying: "We are unable to see that it was engaged in any other business than that of owning property." The question of depreciation and its allowance or disallowance was not adverted to by the Circuit Court of Appeals.

5. *The Minehill case.*

In this case the Railway Company sued the collector to recover excise taxes which it had been compelled to pay for the years 1909 and 1910.

The company owned and operated a railroad for many years prior to 1896, in which year it leased its entire property to the Philadelphia & Reading Railway Co., for 999 years. The Minehill Company agreed to maintain its corporate existence and powers during that period, and to exercise the same whenever needful to enable its lessee to enjoy all

demised rights and privileges relating to the leased property. Since 1896, the entire property has been controlled and operated by the Reading Company, and the Minehill Company has not carried on any business in connection with its operation. It has, however, maintained its corporate existence, and an office at which stock-books for the transfer of its shares of stock are kept; has received the annual rentals, collected interest on its bank deposits and the income derived from a contingent fund established and invested by it, and has distributed a portion of its annual income to its stockholders in dividends.

The precise question presented for determination in this case was defined by *Mr. Justice Pitney*, as follows:

> "Whether the Minehill Company is 'doing business', in the sense in which the Realty Companies concerned in *Flint v. Stone-Tracy Co.* were doing business, or had gone out of business, in substantially the same sense that the Minneapolis Syndicate [in the *Zonne case*] had done so."

It was concluded that, by reason of the lease of its property, the Minehill Company was not engaged at all in the business of maintaining and operating a railroad, which was the prime purpose of its incorporation, and was not, on that account, taxable for the years named.

The court also determined that, from the fact of the retention by the company of its franchise and corporate existence, and the maintenance of its organization, it is not to be treated as doing business

in respect of the railroad within the meaning of the corporation tax act.

Finally, it was held that the receipt of rentals under the lease, and of income from invested funds and bank deposits, and the distribution thereof among its stockholders, could not be deemed "doing business," but that *such functions amount to no more than receiving the ordinary fruits that arise from the ownership of property;* that the mere receipt of income from property, and the payment of organization and administration expenses incidental to such receipt and the distribution of the income, do not constitute such a business as is taxable under the act of 1909; that the investment of a portion of such receipts, and the receipt of income therefrom, by a corporation that is not engaged in business, except the business of owning property, making and maintaining investments, collecting the income, and dividing it among its stockholders, do not render the corporation taxable.

6. *The Sargent Land Company case.*

This was an action decided July 31, 1913, in connection with two other suits, by *Judge Willard,* in the United States District Court for Minnesota. The company brought suit against the collector of internal revenue for that district, to recover a considerable sum required to be paid by it as corporation taxes for the years 1909, 1910 and 1911. It appeared that a large quantity of land in Minnesota, located in what is now known as the Mesaba Iron Range, had been owned by the partnership of

J. S. Pillsbury & Co., engaged in lumbering. The timber having been cut and removed, an agreement was made by the partners with two individuals, by which the latter were authorized to explore the lands for iron ore, with a provision that, if ore should be discovered thereon, an undivided one-half interest in the lands would be conveyed to them. Ore was subsequently found, and the conveyance duly made. Prior to 1902, each of the partners in J. S. Pillsbury & Co. died, and their respective estates in these lands descended to numerous heirs (a majority of whom were minors) in various interests, some as small as 1/108 of the undivided one-half owned by the partners. The places of residence of the heirs were scattered.

Before the death of any of the original owners, mining leases covering portions of the lands containing iron ore had been made, running for periods of fifty years. To render it practicable to handle and control the properties, and to liquidate the same so as to secure to the heirs as speedy a division of their inheritance as possible, the Sargent Land Company was formed in 1906 for the more convenient handling, improvement, development and disposition of properties owned by the Pillsbury heirs and the two grantees of their ancestors, and the entire title to the lands, subject to the outstanding leases, was vested in the corporation. The remaining portion of the mineral bearing lands was leased in January, 1907, by the Sargent Land Company.

In the fall of 1909, the articles of incorporation were amended so as to provide:

> "The general purpose of the corporation is to unite in one ownership the undivided fractional interests of its various stockholders in lands, tenements and hereditaments, and to own such property, and, for the convenience of its stockholders, to receive and distribute among them the proceeds of any disposition of such property, at such times, in such amounts, and in such manner, as the board of directors may determine."

Substantially the only value in the properties of the company was in the iron ore thereon, all of which had been disposed of by the mining leases referred to at fixed and unchanging rates of royalty.

During the years 1909, 1910 and 1911, the only things done by the corporation were in furtherance of its declared purpose of liquidating the corporate assets, and consisted in receiving royalty payments under the leases, which were immediately distributed to its stockholders; in selling an occasional tract or lot of land, and in collecting nominal rentals on a few of its tracts, largely to protect its title from claims of adverse possession by squatters thereon.

The corporation paid the taxes demanded, under protest (1) that it was not doing business; (2) that receipts from sales of iron ore do not constitute income, and (3) that, if such receipts are income, the corporation was entitled to deduct therefrom the fixed value of the ore disposed of during each year, *as depreciation.*

Judge Willard ordered judgment for the corporation for the recovery of the payments which it had been compelled to make to the collector, upon the ground that its receipts were not "income," but represented only the conversion of capital assets from one form into another.

Referring to the Act of 1909, he said:

"What was intended by the use of the words 'gross income'? What does the word 'income' mean? In ordinary speech people recognize a difference between capital and income. I believe that the ordinary meaning attached to income, when it is not derived from personal exertion, is that it is something produced by capital without impairing that capital, and which leaves the property intact, and that nothing can be called income for the purpose of this act, which takes away from the property itself. If it does, then it ceases to be income and amounts to a sale of capital assets. This definition of the word income I think is deducible from what was said in *Flint v. Stone Tracy Company*, although it is not so distinctly stated. On page 146 the court said: 'The income is not limited to such as is received from property used in the business, strictly speaking.'

"That necessarily means that the property itself remains in the business, and continues to be used in the business, and that income was something that was derived from the use of it, leaving the property intact. On page 165 the court said:

'It is no objection that the measure of taxation is found in the income produced in part from property which of itself considered is non-taxable.'

"It is important to notice that in that connection the court was speaking of government bonds which are not taxable. Income derived from government bonds is money derived from

them without impairing the capital which produced it.

"It follows necessarily from the views which I have expressed that the words 'gross income' do not mean 'gross receipts.' * * *

"That this ore in place is capital, and is part of the real estate, I think admits of no question. It is just as much a part of the real estate as trees standing on the land.

"Let us suppose that John S. Pillsbury & Company, when it owned this land with the timber still standing thereon, was a corporation; that in 1908 it sold the timber with the privilege of removing it within ten years, and that in 1909, 1910 and 1911, the purchaser cut the timber and during those years paid the purchase price of it. Could it be said that the purchase price so received was income within the meaning of this act? I do not think that it could. It was not income, it was the property itself; and, as I said before, the trees standing on the land are no more a part of the realty than is the ore under the surface of the land. They are both capital, and money derived from a sale thereof cannot be considered income, whether it be money received from the ore, or money received from the timber."

(For convenient reference, this case not having been as yet reported, the opinion of Judge Willard in full is printed as an appendix hereto.)

7. *The Stratton's Independence, Limited, case.*

In the decision in this case, in the court of first instance, a diametrically opposite view was expressed from that of *Judge Willard* as to what is meant by income, and from that entertained by *Judge Lacombe* as to allowance for depreciation. These views of the trial court were based upon the following reasoning:

(1) *As to income:*

"In the popular sense the net income of mining properties is the value of what is extracted, after deducting the cost of extraction and treatment, and the cost of administering the company which may be conducting the operations, and finally, after a reasonable reservation for contingencies. This is true, not only as a matter of general understanding, but has been held uniformly by the courts to be a proper rule in determining whether or not a dividend is declarable by such companies. * * * If, therefore, the net income is not affected, for the purposes of dividends, by the amount of ore extracted, neither should it be affected by that circumstance for the purposes of an excise tax. We conclude, therefore, that the words 'net income' do not carry with them any contemplation of the law that there should be such a deduction as plaintiffs here claim."

(2) *As to depreciation:*

"Its practical result will be to free mining companies from any substantial obligations under this statute, since the value of ore in place when extracted, plus the cost of extraction and the several other items which are properly allowable under the statute as against the proceeds therefrom, will, in practically all instances, leave little or nothing as the net income to be assessed by the government. Of course, the results of a given construction are not to be calculated with if the intent of the statute is plain, and, if the statutory intent is clear that such corporations are exempt, the result is not a matter of judicial concern. At the same time, in determining what is the meaning of a statute, the effect of a construction contended for is of some relevancy as throwing light upon the congressional intent. We have here a class of corporations which owe their possession of property at all to a

very liberal system of our government, by which mining property is acquired, being simply by possession, development and final payment of what is in many cases an insignificant amount as compared with the value of the property. We are also dealing with a class of corporations to whom the use of corporate functions is perhaps of more value and importance than in any other branch of industry. Mining is essentially a class of activity which owes its life to aggregate contributions rather than individual enterprise. The statute, which finds its justification in the power to tax the carrying on or doing business, is peculiarly applicable to mining corporations in which the corporate function is of such value.

"Viewing the matter from these two standpoints, therefore—one the source from which the property comes and the other the value of the corporate life—there results an initial presumption that Congress had in mind this class of corporations, along with others, and that unless the terms of the statute otherwise demonstrate they are to be considered as included within the provisions of the act.

"The ordinary definition of depreciation is the lessening of value. As applied to mining properties, the word carries with it, as in the case of any other business, the idea of deterioration in *visible improvements, such as mills and other surface structures* and perhaps the underground improvements so far as they are put in by the hand of man, and, therefore, speaking popularly, when we think of depreciation in mining properties, we think of a lessening in value by time, or perhaps by accident, of those physical elements which go to develop and improve the property. Now, does this meaning, commonly entertained and accepted and which is common to every class of corporations, become enlarged in case of mining companies so as to make the extraction of ore likewise an element of depreciation? The

court's view is that it does not. This conclusion is in part induced by the reasons which have been above discussed in connection with the term 'net income' and in part by the peculiar nature of the mining business. This latter is *sui generis*. It lives by dying. It is a business that is intrinsically uncertain. The segregation of part of a stock of goods is a definite detraction from the whole. The excavation of a body of ore, however, may reveal other bodies and result in immeasurable increment. The taking out of ore while in a sense depreciation from the body, very often leads to the revealing of still larger bodies, and thus results not in a lessening of the value of the claim, but in a great increase in such value. Mining excavation, when properly conducted, is very often more a development than a waste or a detraction. As applied to this class of corporation, having as its purpose to exhaust—it may be a year hence or a hundred years hence—the body of ore for profit, the mere fact that ore may be extracted does not in my judgment make the value of such ore an element to be classed and deducted as a depreciation of the property. The court, therefore, holds as to this second provision of the statute that the extraction of ore does not constitute a credit in favor of mining companies upon the account between them and the government when this excise tax is to be assessed."

These decisions may be summarized as follows:

1. A corporation which has leased its property and surrendered the control and operation thereof is not carrying on or doing business in respect of such property.

Zonne v. Minneapolis Syndicate.

McCoach v. Minehill Company.

S. P. United States v. Nipissing Mines Company.

2. A corporation is not subject to the federal tax merely because of the ownership and enjoyment of property.

Flint v. Stone Tracy Company.

McCoach v. Minehill Company.

United States v. Nipissing Mines Company (C. C. A.)

3. A corporation which amends its charter so as to disqualify it from business activity in respect of its property is not subject to the imposition of the tax.

Zonne v. Minneapolis Syndicate.

But see opinion of Willard, J., in Sargent Land Company v. von Baumbach.

4. A corporation which has leased its properties to another which operates or develops them and pays rentals, royalties or earnings therefrom to the former, is not doing business and taxable.

Zonne v. Minneapolis Syndicate.

United States v. Nipissing Mines Company.

But see opinion of Willard, J., in Sargent Land Company v. von Baumbach.

5. Receipts from sales of capital assets, whether ore or property of other character, are not "income," but merely a conversion of property from one form to another.

Sargent Land Company v. von Baumbach.

Contra: *Stratton's Independence, Limited, v. Howbert.*

6. A mining company is entitled to deduct from its gross income from ore-sales the value in place

of the ore sold, as constituting a diminution or depreciation of its capital assets.

Per Judge Lacombe in Nipissing Mines Case.

Contra: *Stratton's Independence, Limited, v. Howbert.*

I.

Section 38 of the Act of August 5, 1909, does not apply to mining corporations.

The first question certified by the Circuit Court of Appeals should be answered in the negative—at least as applied to the instant case. The corporation here is a mining company engaged only in mining and reducing ore from its own premises; that is, in converting its only assets from one form into another. In its unconverted state, that property is unavailable and useless for practical purposes; the activity of the company transmutes it into a useable and practicable condition where it has an immediate availability and becomes the representative and standard of all recognized values. *In so doing, the company is simply exercising one of the prerogatives of the ownership of property.* It is not manufacturing, it is not trading, but it is simply, by its own exertions, rendering its assets marketable and converting them into money.

This court has adopted the universal definition of "business," as being that which occupies the time, attention and labor of men for the purpose of a livelihood or profit.

Flint v. Stone Tracy Company, 220 U. S. 171.

The mere conversion of assets by the owner does not fall within this definition. If it did, the man who sold his home, or the widow who sold her cow, in order to obtain ready money for living expenses or any other need, would be doing business and be-

come subject to an occupation tax if one were now exacted.

"An indispensable criterion of business is that profit is intended."

State v. Boston Club, 45 La. Ann., 585.

"It implies operations conducted with a view to the realizing of profits which come from skillful purchase, barter, speculation and sale."

Graham v. Hendricks, 22 La. Ann., 524.

As defined by the Supreme Court of Rhode Island, a "business corporation" is one engaged in financial dealings, buying and selling, traffic in general, or mercantile transactions.

Greenough v. Com'rs., 74 Atl. Rep., 785.

Stratton's Independence, Limited, is clearly within none of these definitions. On the contrary, it is one of the class expressly recognized by the decisions above collated (other than the decision of *Judge Pope* in the District Court in this case) as being exempt from taxation under the Act of 1909. It is not carrying on or doing business, but is simply performing the functions which enable it to derive from its own assets "the ordinary fruits that arise from the ownership of property," in the words of *Mr. Justice Pitney*.

As declared by *Chief Justice Fuller* in the *Pollock case* (158 U. S. 625-6), property is but a fiction without the beneficial use of it. To hold, therefore, that a corporation may own mineral properties but can have no beneficial use of them without being subject to taxation, is to deny the very

right of property, and, when reduced to its lowest terms, is to impose a tax *solely because of the ownership of property*, which it was agreed, in the *Flint case* (220 U. S. 150), the act under consideration did not contemplate.

In *In re Elk Park Mining & Milling Company*, 110 Fed. 422, it was said:

> "I do not think a mining corporation can be regarded as a trading corporation, or that it is in mercantile pursuits. * * * Certainly a mining company which is organized for operating a mine and getting precious metals from it, cannot be said to be engaged in any species of trading."
>
> See also *In re Chesapeake Oyster & Fish Company*, 112 Fed. 960.

In so far as a company is simply engaged in disposing of its existing assets and in putting them to the only practical and reasonable beneficial use of which they are susceptible, it falls far short of being a business corporation within the contemplation of the congress in the enactment of the Act of 1909.

In this regard, it would seem that the argument and conclusion of *Judge Willard* in the *Sargent Land Company case* are at fault. There the company owned mineral lands all of which were leased for periods of fifty years, the leases reserving to the owner of the fee the privilege of going upon the properties for the purpose of inspection to ascertain whether the lessees were properly observing the terms of their leases, and also of computing the quantities of ore mined and shipped by

the lessees. *Judge Willard* said:

"It is true that in this case valuable property has been leased for a number of years, and that the companies, so far as that property is concerned, received royalties. In this respect they are similar to the *Zonne case*. But in the *Zonne case*, so far as the report of that case shows, the owner of the land had nothing to do with the management of the business. It had no supervision over the renting of the building and had no interest in supervising it. Here the evidence shows directly the contrary. It shows that under the terms of the lease the owners of this property have the right to inspect the work in the mines as it proceeds. It not only shows that the companies have that right, but it shows that they in fact exercised it and are exercising it. It shows that they are doing that for their own advantage, for the purpose of seeing that all the ore which is valuable and which the lessees are bound to take out, is taken out, * * * showing, in fact, that the lessors, so far from remaining idle and passive, and doing nothing but receiving the rent which was paid to them, exercised constant watch and care over the operations of the lessees. They did that, and they must have done it necessarily, I assume, because the testimony is that they considered it for their advantage and profit to do so. If that were all that the evidence showed, I should say that this case was radically distinguished from the *Zonne case*, also radically distinguished from the *Nipissing case* and from the *Minehill case*, because in no one of those cases did the lessor have anything whatever to do with the operation of the physical property. In all three of those cases the lessors simply received the money. They exercised no supervision over the management of the property, and had no right to do so, so far as the cases show."

It would seem quite clear that the right and exercise of the power of inspection or watchfulness over its own property cannot serve to turn an otherwise inactive corporation (for the articles of incorporation of the Sargent Land Company had been amended in substantially the same manner as those of the Minneapolis Syndicate) into a corporation carrying on or doing business. It was simply employing one of the rights belonging to every property owner, whether in possession or not, in seeing to it that its property should not be wasted or improperly handled or employed by those in possession. The authority to be watchful of one's own, for its protection or conservation, even if it be leased to, or otherwise under the control of, another, is one of the natural rights of ownership and in no wise dependent upon contract. The Minneapolis Syndicate (in the *Zonne case*), if it be assumed that the lease of its land granted it no right of inspection, was certainly not precluded from informing itself in what manner its tenant was using the property, or from protesting against improper, unauthorized or unlawful use of the premises. And because the Minneapolis Syndicate may do so, and because the Minehill Company may do so in respect of its railway, does not convert them into corporations doing business. Such action is simply a step of ordinary prudence, and one of the proper and well warranted uses incidental to the ownership of property.

In like manner the development of one's property *in order to secure the beneficial enjoyment*

and value thereof is a mere concomitant of ownership, whether that development consists in extracting precious metal from quartz, or in shearing the fleece from a sheep.

As a property owner, a corporation enjoys, in this respect, the same privilege as an individual.

At the time of the submission of the *Zonne case* in this court, it was contended by the solicitor general that, because the Minneapolis Syndicate, in its amended articles, retained the right to distribute to its stockholders *the proceeds of any disposition of its property*, it must be deemed a business corporation. That contention, however, was not sustained by this court, and was emphatically negatived in its later decision in the *Minehill case*.

The most that can be said of Strattons' Independence, Limited, is, that it is distributing to its stockholders the proceeds of the disposition of its property. It is doing nothing else than liquidating its assets, not for the purpose of reinvestment in trade or any other pursuit for gain, but simply for division of the proceeds among the individuals constituting the corporation. It is constantly diminishing its assets instead of adding to them by gain, which as we have seen, is an indispensable element of "doing business."

Similarly, those corporations which (whether in settlement of estates or otherwise) are effecting such liquidation through leases of their entire properties, as well as those which have leased a part of their properties only and are liquidating the remainder as occasion offers, and are simply

receiving and distributing the proceeds of such disposition of their assets, fall clearly within the principle of the *Zonne, Minehill and Nipissing cases*, and section 38 of the Act of 1909 does not apply to them.

Under the fundamental and elementary rule that a distinct authority must exist to warrant the imposition of any tax, it may be safely urged that no mining companies in view of the peculiar purposes and methods necessarily connected therewith, fall within the scope of the corporation tax law. It is essential that they appear to be directly embraced in its provisions, they cannot be included by implication or by construction.

Hence, as to the first question, it is submitted that it should be answered in the negative.

II.

ARE THE PROCEEDS OF ORES MINED BY A CORPORATION FROM ITS OWN PREMISES, INCOME, WITHIN THE MEANING OF THE ACT OF AUGUST 5, 1909?

It is to be observed that the statute carefully employs the word "income," with reference to both gross income and net income, and not the word "receipts." This use of the word was presumably *ex industria* and not merely fortuitous.

The tax imposed by the law is measured by the net income of corporations subject to the tax, and such net income is to be ascertained in a manner

specified in the law, by making certain deductions from the gross income. While it is true that no definition of what constitutes gross income is attempted, yet the fair construction of the act, and the common sense presumption, necessarily preclude the interpretation of "gross income" as meaning "gross receipts."

By paragraph Third of section 38, the form of return to be made by corporations is prescribed, and it is provided that it shall set forth, "—(fourth) "the total amount of all the ordinary and necessary "expenses actually paid out of *earnings* in the main- "tenance and operation of the business and prop- "erties of such corporation within the year." The return thus required is for the purpose of itemizing *the permitted deductions from gross income*, in order to arrive at the remainder, or "net income," which shall measure the tax; and the use of the word "*earnings*" discloses very distinctly the intention of the Congress that the "gross income" with which the act deals is "*gross earnings*" and not gross receipts.

In the ordinary significance of the term "income," it means profits, earnings, gains or increases, and not receipts. Thus, one derives income from payments of interest upon a bond, but, when the bond matures and is paid off, the principal received is never considered as income, although it is distinctly an item of cash receipts and would so be entered on the owner's books.

The same is true of a mortgage debt, the interest on the mortgage alone being considered as income.

Again, if real or personal property be sold upon a contract which reserves payments of annual or semi-annual interest upon the unpaid portion of the selling price, such interest only is entered to the account of income, and the payment of the principal in installments or otherwise is not accounted for as income.

If a manufacturing or mercantile company, or a corporation engaged in other business, own a factory, store or warehouse, and, by reason of change of location or otherwise, sell the property, the money received therefor, although immediately reinvested in another building, would be entered in its cash receipts, but would not be deemed income and could not be considered in measuring the corporation tax.

It is a common practice for large grain commission houses to advance moneys to country grain buyers, to enable them to buy grain which they are expected to ship for disposition to the commission house advancing the money, the lenders reimbursing themselves out of the proceeds. In such cases, the interest paid upon the sums advanced would be income, and the commissions accruing from the handling and sale of the grain at terminal points would be income, in respect of which a commission house would be required to pay a corporation tax; but no one would contend that when, out of the proceeds of the grain, it repaid itself the principal of its advances, the commission company must pay a tax based thereon—and yet the cash so received by it is a part of its gross receipts.

On December 3, 1909, the treasury department issued a circular embodying regulations in respect of the corporation tax, setting out, in part, the government's interpretation of the law. In that circular we find the following language:

> "Article 2—*Gross income.* The following definitions and rules are given for determining the gross income for the various classes of corporations:
>
> 1A. *Banks and other financial institutions.* * * *
>
> 1B. *Insurance companies.*—Same as 1A above.
>
> 2. *Transportation companies.*—Same as 1A above.
>
> 3. *Manufacturing companies.*—Gross income received during the year from all sources will consist of the total amount, ascertained through an accounting, that shows *the difference between the price received for goods as sold and the cost of such goods as manufactured.* * * *
>
> 4. *Mercantile companies.*—Gross amount of income received during the year consists of the total amount ascertained through inventory, or its equivalent, which shows *the difference between the price received for goods sold and the cost of goods purchased during the year, with an addition of a charge, to the account, of the sum of the inventory at the beginning of the year, and a credit to the account of the sum of the inventory at the end of the year.*
>
> 5. *Miscellaneous.*—Gross income consists of the gross revenue derived from the operation and management of the business and property of the corporation making the return, together with all amounts of income * * * derived from all other sources, as shown by the entries on the books from January 1 to December 31 of the year for which return is made.
>
> "*It will be noted from these definitions that gross income is practically the same as gross*

profits, the only difference being that gross income is more inclusive, embracing, as it does, not only gross profits of the corporation but also all amounts of income from other sources.

6. *Sale of capital assets.*—In ascertaining income derived from the sale of capital assets, if the assets were acquired *subsequent* to January 1, 1909, *the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income, according to whether the selling price was greater or less than the buying price.* If the capital assets were acquired *prior* to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which proportion shall be deducted from or added to the gross income for the year in which the sale was made."

Aside from the direct announcement "that *gross income* is practically the same as *gross profits,*" the fact that "gross receipts" is not understood by the department as being synonomous with the "gross income" of the statute is clearly shown by the attempt to define what shall constitute gross income in the various classes of companies. Without exception, the gross expenses (*of which value or cost of material or property used or sold is part*), are authorized to be deducted from the gross receipts of a corporation in order to arrive at its gross income, i. e., its gross earnings.

As respects mercantile companies, the sum of the inventory (*that is, the value of the corporate assets*) at the beginning of the year is to be de-

ducted also, while the value of the corporate assets (or sum of the inventory) at the end of the year is to be added.

Thus, under the rule promulgated, a mercantile corporation receiving $100,000 for goods sold during a tax year, would deduct therefrom current expenses and the cost of goods purchased during the same year, say $80,000, showing a gross gain of $20,000. To this is to be added the inventory value of the corporate assets at the end of the year, which we will presume to be $45,000, making a total of $65,000, from which the sum of the inventory at the beginning of the year, which we will fix at $50,000, is to be deducted, leaving a gross income of $15,000. Or, by a simpler calculation, the sales have exceeded the purchases and costs by $20,000, while the assets have decreased $5,000, leaving $15,000 as gross income.

In subdivision 5, relating to miscellaneous corporations, gross income is defined as "the gross "*revenue* derived from the operation and manage- "ment of the business." This introduces a new term, "revenue." What does that mean?

In *People v. New York Central Company*, 24 N. Y. 485-490, "revenue" was defined as a *return for capital invested, or labor bestowed.* In a general sense, it is the actual rents, profits, interests or issues of any species of property, real or personal, belonging to an individual or to the public.

It is thus seen that that road, too, leads to the same destination.

What does an inventory of a mining corporation show at the end of a business year? Exact values of its ore deposits being impossible of ascertainment, it can, nevertheless, determine with entire accuracy, the difference between their value at the beginning and the end of the year by determining the value in place of the ore which has been removed and sold. In that degree its assets have diminished, and by that amount its inventory or accounting values must be reduced at the end of the year, precisely as is permitted under the terms of the act, and the regulations of the Commissioner, to a mercantile corporation.

"Gross income," consequently, as the circular of December 3, 1909, recognized, is substantially "gross profits" from which the deductions specified in paragraph second of section 38, of the Act of 1909, are to be made in order to arrive at net income.

Any other construction would be intolerable. Thus, it is conceivable that a manufacturing or mercantile house might have gross receipts of five millions of dollars, with gross profits of one hundred thousand dollars or less, or even no gross profits at all; and it is perfectly palpable that such gross receipts could, by no rational construction of the act, be deemed intended as the basis for computing the tax to be paid. The clear theory of the law is that corporations shall be taxable only in respect of carrying on or doing business, and then only in proportion to the amount of net income or profits which such business may produce

during the tax year, plus net income from other sources.

The act must be interpreted in the same way for all corporations within its embrace. Even the government will not contend that it should not operate equally upon all corporations to which it is applicable.

Since it is apparent that, *as to mercantile and other companies*, under the classification made by the circular of December 3, 1909, *gross profits* represent their "gross income," how can it be insisted that, *as to mining companies*, the "gross income" is represented by their *gross receipts?*

The trial judge in this case endeavored to answer this by the assertions: (1) that, according to ordinary understanding, ore extracted is not deemed an element to be reckoned with in determining the net income; the net income of mining properties being the value of what is extracted after subtracting costs of extraction, etc.; (2) that it has been held universally by the courts to be a proper rule to consider net receipts from sales of ore as net income in determining whether or not a dividend is declarable by such companies.

Neither of these answers appears sufficient, nor is either deducible from the reasoning employed to support them.

In the first place, it is at least of doubtful accuracy to assert that the net returns from sales of ore constitute the net income of the mine, without an allowance for the value in place of the ore removed from the property, and sold to produce

such returns. Confessedly, by such removal the volume of the ore deposits has been reduced; to that extent value has actually been taken from the land without possibility of replacing it; after the ore is removed, the property has an intrinsic worth of precisely as much less as the value of that ore in place, and the actual assets of the corporation have been diminished in exactly the same degree. Whereas on the first day of January of a given tax-year the corporation was the owner of a certain quantity of ore in place, on the 31st day of December of such year its ore deposits were depleted by the exact quantity of ore removed during the year.

No amount of ingenious reasoning can alter these facts and their effect. And that effect is defined by the word "depreciation." This was the view of *Judge Lacombe* in the *Nipissing case*.

It is true that a mine is inherently a wasting property—a fact which its owners must necessarily recognize; but that circumstance cannot avail to nullify the established and immutable principles of business, of law, and of logic; namely, that "net income," outside of personal earnings, indubitably and invariably connotes a gain or increment derived from the capital assets, and cannot include the capital itself.

Speaking generally, a mining enterprise contemplates not profit, but a conversion of the minerals in place into their cash equivalent; and the ultimate purpose of such an enterprise is always to exhaust the capital assets by liquidating them

so that they may be distributed to the owners.

This peculiar characteristic of mining enterprises explains clearly and simply why, in their case, the courts have declared that dividends so called (although in reality they are only distributions of capital) are permitted out of proceeds of sales, or capital assets, when they would be forbidden to commercial or other corporations. Hence the argument of *Judge Pope* that, because they are distributed to the stockholders, the receipts from ore sales are income, fails. The fact that any such distribution is, for convenience, called a *dividend*, cannot have the effect of destroying the nature of the funds so distributed, and of metamorphosing capital into income; neither can it change the legal rights of the corporation or its stockholders, or the legal character and status of its property.

"Income" then, as deduced alike from the circular of the commissioner of internal revenue and from the Act itself, must be taken to mean the *gain* produced by the business operations of the corporation taxed, plus the receipt from other sources in the nature of interest, dividends or rent. The language of both is equally conclusive that the capital assets of the corporation, either in their original form or when converted into money or other property, are not to be considered as part of the corporate income. The ordinary meaning attaching to the word "income" would not permit such a construction, and, under the familiar rule, the congress is presumed—the contrary not appear-

ing—to have used the language employed in the Act in its ordinary signification.

The courts have very clearly declared the meaning which should attach to the word income.

In *Appeal of Braun*, 105 Pa. 414, 415, income is defined as "that *gain* which proceeds from labor, business or property of any kind; the profits of commerce or business."

So the civil codes of those states which have adopted them, North Dakota, South Dakota and California, define income as including the *rents and profits of real property*; the *interest of money; dividends upon stock*, and other *produce of personal property*.

> *Revised Code, North Dakota*, Sec. 3322; *Civil Code, South Dakota*, Sec. 238; *Civil Code, California*, Sec. 748.

In *Gehr v. Iron Company*, 174 Pa. 430, 34 Atl. 638, it was held, in passing upon the rights of different classes of creditors to participate therein, that a fund resulting from sales of materials, manufactured iron, products of iron and coal lands, etc., disposed of by a receiver for the purpose of winding up the affairs and distributing the assets of a corporation, could not be deemed income.

In *Levi v. Louisville*, 97 Ky. 394, in discussing the definition of "income tax," the imposition of which was expressly authorized by the constitution of Kentucky, the court said that the income tax relates to the *product* or income from property or from business pursuits.

In *Mundy v. Van Hoose*, 104 Ga. 625, the court said:

> "Income as defined by Mr. Webster is 'that *gain* which proceeds from labor, business, property or capital of any kind—as the produce of a farm, the rent of houses, the proceeds of professional business, the *profits* of commerce or occupation, or the interest of money or stock in funds, etc.' The definition demonstrates the distinction between *capital assets* and the *income* which they produce; the latter is the profits, product or gain derived from the use or investment of the former."

As stated by *Judge Willard* in his opinion in the *Sargent Land Company case*:

> "I believe that the ordinary meaning attached to income, when it is not derived from personal exertion, is that it is something produced by capital without impairing that capital, and which leaves the property intact, and that nothing can be called income, for the purpose of this act, which takes away from the property itself."

In *Spooner v. Phillips*, 62 Conn. 262, we find:

> "The word 'income' has a broader meaning [than dividends], *but hardly broad enough to include things not separated in some way from the principal.* It is not synonomous with 'increase.' The value of stock may be increased by good management, prospects of business and the like. But such increase is not income. It may also be increased by an accumulation of surplus; but so long as that surplus is retained by the corporation, either as surplus or increased stock, it can, in no proper sense, be called 'income.'"

If Stratton's Independence, Limited, or any other corporation owning mineral property, should

exchange its property as a whole for a business building in the city of Denver, for instance, could it be claimed for a moment that the value of the building constituted income by which a tax upon the corporation could be measured; or, if the plaintiff corporation should sell its entire property for cash, would it be required to pay a corporation tax based upon the whole amount of cash so received? Is there any conceivable difference between selling the entire property, in which case it is obvious that no tax would be assessable, and selling that portion of it which was disposed of by the corporation during the year 1909, and upon the market value of which the tax in controversy was assessed? Can it make any difference, as respects the Act of 1909, that the conversion is in installments instead of in gross?

When the plaintiff in this case acquired the mining property, it acquired, as part of it, that ore which was sold during the tax year here involved, and it became a part of its capital assets. By what reasoning can it be asserted that the change from the mineral in place to its cash equivalent converts the latter from capital assets into income, for the purposes of the corporation tax law? Certainly the cash so received, for any other purpose, still constituted a part of the capital of the corporation.

It is submitted that the answer to the second question certified to this court should be No.

The decision of the Circuit Court of Appeals in the *Nipissing Mines case* disposes of the question

in the same way, as respects inactive holding-companies the income of which is derived from mines; and, by parity of reasoning, the same principle must govern those corporations which, although the actual owners of the mines, do not themselves operate them, but receive the returns for ore extracted therefrom in the form of royalties paid under mining leases. In whatever manner the ores may be removed, whether by the owners or by lessees, their proceeds represent *conversion of principal* and not income.

III.

As To Depreciation.

Much of the preceding argument is applicable to the question of depreciation; but what here follows is based upon the assumption that the conclusion of the trial court was right, that receipts from sales of ore, mined by it from its own property, are to be considered, under the Act of 1909, as being gross income of a corporation carrying on business.

The statute directs that the net income by which the tax is measured shall be ascertained by deducting from the gross income of the corporation (among other items) "a reasonable allowance for depreciation of property."

If the value in place of ore removed and sold cannot properly be subtracted from gross receipts in arriving at such gross income, then it is apparent that, under the provision referred to, it must

be deducted from gross income, in order to determine the *net income*. As has been shown, the mining and removal of ore must constitute an element either of "depreciation", or of loss actually sustained. Before removal, the ore is a part of the "property" or capital assets of the corporation, and for every ounce or ton of ore mined and shipped away there is a corresponding diminution of assets. Such property being, in the present case, when in marketable condition, the particular metal which, when stamped, constitutes money, it is obvious that its value is actual and stable, and that, with every dollar's worth removed, the land from which it is taken contains that much less of value; the corporation owns precisely that much less real property than it possessed before; for every dollar of cash received, it relinquishes an equivalent amount of ore in place, and makes no gain or profit by the exchange. Should it exchange the ore for lands instead of for money, the situation would be no different; if it retain the lands, it may not claim depreciation of assets, but neither can it be charged with a tax on account of the value of the land *as income*.

These conclusions were apparently recognized and accepted by the commissioner of internal revenue when, under date of December 15, 1911, he issued an additional circular, paragraphs numbered 97 to 105 of which relate specifically to "depreciation" in coals, minerals, etc.

In this connection it may be remarked that, in his zeal to produce revenue for the govern-

ment, the commissioner appears to have assumed legislative functions, and arbitrarily to have added to the Act of August 5th various provisions, which have no warrant in the act, as passed by Congress and approved by the president. For instance, he attempts to establish for corporations acquiring mineral properties after January 1, 1909, a very different rule from that governing corporations which acquired their mineral properties before that date. In pursuance of his scheme of taxation, he formulated a most complicated and impracticable scheme of accounting, and attempted to extend the law so as to require payment of a tax based, not only upon the net income, but also upon the "unearned increment" which may accrue upon mineral properties.

As far as his scheme is comprehensible, it appears to be that a corporation which acquired its mineral properties *before* January 1, 1909, may exclude this unearned increment (which term we understand to signify to the commissioner the difference between the original cost of the property and its value on the first day of January, 1909) from the gross income of the year in which sales of minerals are made, so far as the unearned increment attaches to the quantity of ore sold in that year. In other words, the increase in value of mineral properties acquired before January 1, 1909, is not taken into consideration in determining the amount of the tax.

As respects corporations which have acquired mineral properties *after* January 1, 1909, the com-

missioner proposes to compel them to pay a tax measured by the net income plus the unearned increment.

We deny the authority of the commissioner to extend the scope of the act by any such regulations or in any such manner, or to apply the law in one way to one class of corporations and in a radically different way to another class. There is nothing in the language of the act which indicates a legislative intent to give to the words "gross income" the meaning of "gross receipts" as respects corporations owing mining properties, and, as respects all others, the meaning of "gross earnings;" or to enlarge the commonly understood and accepted definition of "net income," so that, for the purposes of the act, it shall include "unearned increment."

However this may be, the circular of December 15, 1911, provides:

> "97. In the ascertainment of net income deduction will be allowed for depreciation arising from exhaustion of deposits of ore, mineral, etc., and for depreciation and obsolescence of improvements, in accordance with general regulations respecting depreciation allowances, on the basis of *the original capital investment* cost of the properties concerned to the company reporting.
>
> 98. A further deduction will also be allowed, through not including the same at all in the item of gross income, for *the unearned increment* represented in such properties as at January 1, 1909.
>
> 101. * * * The question as to whether it subsequently develops [that] the property possessed a greater quantity of mineral, etc., reserve than was, in the aggregate, estimated

as of January 1, 1909, is immaterial. Any excess which may be developed will be considered as possessing the same value at January, 1909, as that which then may have been known to be in the property.

103. As the amount to be deducted for depreciation is to be formed on the basis of the estimated reserve of minerals, etc., it follows that if it develops [that] such estimate is understated, the cost investment in the capital assets may be wholly extinguished before all mineral reserves are removed. When this is reached, *further deductions for exhaustion of minerals should be discontinued*, but in such event it will be noted, the allowance for unearned increment, which is to be excluded entirely from gross income, will be correspondingly increased.

105. In respect to properties of the character in question, which may be acquired by a corporation *after* January 1, 1909, a deduction will be allowed only as to depreciation arising from exhaustion, *based on original cost; no exclusion from gross income can be made for unearned increment*, as profit arising from any sale of such capital assets applies wholly to the period subsequent to January 1, 1909."

The right to the depreciation claimed by the plaintiff and other owners of mineral properties is thus distinctly recognized by paragraph 97. The commissioner attempts to limit it, however, by the words "on the basis of the original capital investment cost of the properties concerned to the company reporting." The theory of this qualification is that no depreciation can be permitted which, in the aggregate, will exceed the actual cost of the property to the corporation. This position was evidently assumed to give effect to the "unearned

increment" theory of the commissioner, to which, as "net income," he assumes to apply the Act of August 5.

There is no hint in the language of the act itself that it was the design of the Congress to deprive a corporation of the benefit of a good bargain in the original acquisition of its property.

Manifestly, so far as the Act of August 5th is concerned, the "capital cost" of property possessed by a corporation December 31, 1908, was *the value of the property at that date.*

Regardless of its cost, and regardless of the nominal stock capital, the property acquired by a corporation is its *actual* capital, and there is no rule of law which requires that the amount of the capital stock of a corporation shall equal the value of its assets. Thus, the Supreme Court of California in *Excelsior Water & Mining Company v. Pierce*, 90 Cal. 131, said:

> "The term "capital stock" has a double meaning as applied to corporations; in one sense it is the sum mentioned in the articles of incorporation as the amount of the capital stock; in other words, it is the share capital, or nominal capital, and does not necessarily represent a corresponding amount of actual capital. In case of mining corporations it is always arbitrary and generally extravagant in amount. The capital stock referred to in the statute (which forbids directors of corporations to make dividends except from surplus profits arising from the business thereof) is the actual *property* of the corporation contributed by the shareholders of the nominal capital.
>
> In this case the nominal or share capital of the plaintiff was $5,000,000; its *actual* capital

was its mining and other property received in exchange for the shares which it issued, and this actual capital was what it was forbidden to divide. This inhibition, however, did not extend to the net proceeds of its mining operations; for a mining corporation, like any other corporation organized for the purpose of utilizing and wasting property—a property that can be used only by consuming it, as a mine, a lease or a patent—is not deemed to have divided its capital merely because its has distributed the net proceeds of its mining operations, although the necessary result is that so much has been subtracted from the substance of its estate."

In respect of corporations acquiring mineral properties *after* January 1, 1909, it is submitted that no different rule can be applied.

From their nature, the value of minerals in place is impossible of definite ascertainment, but whatever values they may possess, they are just as much the property of the corporation, irrespective of the date of acquisition; and whether the price paid was in excess of, or less than, the actual value as ultimately disclosed when the ore bodies have been exhausted, must be immaterial in the application of the act involved in this case.

The whole matter turns upon the meaning of the word "depreciation." It has, and from its derivation can have, but one definition as applied to property, namely, *reduction of worth* (Century Dictionary). That is its ordinary and accepted signification, it was so defined by the District Court in this case—"lessening of value,"—and in that sense it was used by the Congress. This is self-evident.

The question then, reduced to its lowest terms, is: Does the removal of valuable ore from a mine reduce its worth? An inquiry in that form translates us to that rudimentary period of our mental development when we wrestled with the problems: If a boy having six apples gives two to his sister, how many has he left? Is four more or less than six?

It is unnecessary to dwell upon the contention of the commissioner of internal revenue that unless a "depreciation account" be kept upon the books of a corporation no deduction can be made for actual, and otherwise allowable, depreciation of capital assets. Such a requirement is both outside the specifications of the statute, and entirely illogical and unreasonable. Both *Judge Lacombe* in the *Nipissing Mines case*, and *Judge Willard* in the *Sargent Land Co. case*, refused to give any force to this unauthorized regulation.

The determination of the questions presented affects many other corporations than the plaintiff above named, although the particular conditions relating to them may not be identical.

The writer of this brief represents certain corporations which own mineral lands, not operated by themselves but leased to others for operation.

Some corporations acquired such lands before the first day of January, 1909, whereas the plaintiff herein acquired its land after that date. This difference must be borne in mind in formulating an answer to the questions certified by the Circuit Court of Appeals, as the commissioner of internal

revenue makes the circumstance the basis of a vital distinction.

Other corporations are owners, in addition to mineral bearing lands, of properties not used in connection with mining of ores, but which are disposed of by them independently of ore lands and minerals, not, however, for profit or investment, but solely for distribution of proceeds among stockholders in the same manner as the avails of ore sold. Does this fact differentiate such corporations from the plaintiff, so as to require, as to them, a qualification of the answers to the questions certified?

Again, certain corporations have been organized for the purpose of enabling heirs to estates in mineral lands to handle the same, and to liquidate and divide the estate by means of a disposition of the properties. How will the answers to the questions here certified affect such corporations?

It is respectfully submitted that the third question certified in this case should be answered in the affirmative.

Concerning any corporation interested in mineral lands, it is submitted:

1. Where a corporation has leased its entire properties and is inactive in respect of them, it is in no different situation from the corporations involved in the *Minneapolis Syndicate*, the *Minehill*, and the *Nipissing Mines'* cases, and is therefore relieved from the imposition of the corporation tax, upon the ground that it is not carrying on or doing business.

2. Such a corporation, if removing and shipping ores or minerals from its own property, and not engaged otherwise in carrying on or doing business, is, for the same reason, exempt from the corporation tax, because it is exercising merely the rights and privileges inherent in the ownership of such properties, and is enjoying the beneficial uses of such property. Its activity is addressed simply to the conversion of its property into its cash equivalent, without profit or gain, and, hence, without income.

3. The fact that the properties of any such corporation were acquired before or after January 1, 1909, does not affect the question of its liability. The circular of December 15th, 1911, concedes that "unearned increment" may be deducted from gross income, as respects properties owned by the corporation on January 1, 1909; but no warrant appears in the Act of August 5th for the attempted distinction based upon the date of acquisition; nor, by any construction of its language, can the Act be held to measure a corporation tax with reference to such unearned increment. In any event, the properties owned by corporations prior to January 1, 1909, contained at that date the same mineral contents, although not then ascertained, that can ultimately be derived therefrom. All of the ores therein were then a part of the capital assets of the corporation owning them, and can never be augmented. This is especially true of corporations which may have disposed, by lease or otherwise, of their ores, at a fixed rate, prior to January 1,

1909. As to them, beyond all argument, the theory of an unearned increment is inapplicable.

4. A corporation owning, in addition to mineral properties, other lands, possesses the same rights in respect of such lands as in respect of its mineral properties. That is to say, where the purpose of the corporation is not to traffic in real property, but solely to dispose of its lands and liquidate its corporate assets in order to distribute the same among its shareholders, it is merely exercising the common rights of ownership and is not carrying on or doing business within the meaning of the act. If such a corporation have no power to sell its lands except under the penalty of paying a tax, it is deprived of the beneficial use and enjoyment of the inherent rights of ownership.

This is markedly true as respects a corporation which is organized for the purposes of liquidating and distributing among heirs the estates of decedents, where no gain or profit is contemplated but the corporation is organized and utilized as the only practicable method of handling and disposing of the estate, whether by reason of the absence, minority, or other disability of the heirs, or for the purpose of providing against the always possible contingency of the complication of the title by the death of any of the existing heirs. Such corporations cannot be said to be organized for profit, nor can it properly be asserted that they are carrying on or doing business, and certainly the conversion of the corporate properties into money does not constitute the latter gross income for

which an accounting must be made in any form under the Act of August 5th.

The conceptions of *Judge Willard*, expressed in his opinion in the *Sargent Land Company case*, that every corporation, except corporations for social, charitable or beneficient purposes, must be deemed business corporations and be deemed to be organized for profit, because the carrying out of the corporate purpose, whatever that may be, constitutes, as respects the corporation, "business," and because, even if there be no pecuniary gain, there must be some advantage (or profit) to its stockholders from acting in a corporate capacity, appear to be untenable. "Business," under the law, connotes some activity for the purpose of acquiring a livelihood or profit. The Minneapolis Syndicate, Minehill Railway Co. and the Nipissing Mines Co. were, and are, under the doctrine of Judge Willard, carrying on or doing business. "Profit," under the law, means "gain" or "produce," in other words, net earnings or *income;* and a corporation for profit is a corporation organized for earning income or gain. Hence, the Act of 1909 does not embrace an inactive non-earning corporation, even though its stockholders find the corporate form of holding and protecting their property a convenient and advantageous method.

The answers to the questions certified to this court will affect the enforcement of the law in all the various aspects which have been referred to; and it is because of this wider application and in-

fluence that the discussion in this brief has perhaps overstepped the limited scope of the present record.

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APPENDIX.

Opinion of Judge Willard in Sargent Land Company Case.

At the close of the evidence, Willard, J., delivered the following oral opinion:

In the case of *Flint v. Stone-Tracy Company*, 220 U. S. 107, the court held that this is a tax upon the privilege of doing business in a corporate capacity. There are in that statement two elements; one, "doing business," and the other, "in a corporate capacity." That these three companies, the plaintiffs here, are acting in a corporate capacity is unquestioned. It was said in this same case, on page 162, that Congress was justified in imposing an excise tax upon corporations, on account of certain advantages which accrued from carrying on business in that capacity. The court said on page 161:

> "The thing taxed is not the mere dealing in merchandise, in which the actual transactions may be the same, whether conducted by individuals or corporations, but the tax is laid upon the privileges which exist in conducting business with the advantages which inhere in the corporate capacity of those taxed, and which are not enjoyed by private firms or individuals. These advantages are obvious, and have led to the formation of such companies in nearly all branches of trade. The continuity of the business, without interruption by death or dissolution, the transfer of property

> interests by the disposition of shares of stock, the advantages of business controlled and managed by corporate directors, the general absence of individual liability, these and other things inhere in the advantages of business thus conducted, which do not exist when the same business is conducted by private individuals or partnerships."

All of these advantages these corporations enjoy, and the evidence in the case shows that they enjoy them to a higher degree than happens in most corporations. The large number of owners of the property, the fact that some of them were minors, and the fact that the property owned was property which could be leased most advantageously for more than 25 years, in which leases a guardian could not join, show almost a necessity that the owners of these properties should transact business in a corporate capacity. They indicate that these companies would, all other circumstances being equal, be under more obligation to pay this tax than others who did not secure so many advantages from the transaction of business in a corporate capacity. But this is immaterial, and I lay aside, for the purposes of this case, all evidence relating to the complex character of the title and the number of owners, and look at the case in exactly the same way that I would look at it if Mr. Bennett, Mr. Longyear and Mr. Snyder, being the sole owners, had organized the companies.

The principal question on this branch of the case is, whether these corporations are engaged in busi-

ness. The definition of that phrase in *Flint v. Stone-Tracy Company* has already been read by Mr. Van Derlip. The court said at page 171:

> "It remains to consider whether these corporations are engaged in business. 'Business' is a very comprehensive term and embraces everything about which a person can be employed. *Black's Law Dict.* 158, citing *People v. Commissioners of Taxes*, 23 N. Y. 242, 244. 'That which occupies the time, attention and labor of men for the purpose of a livelihood or profit.' *Bouvier's Law Dictionary*, Vol. I, page 273."

It is said that this case is identical with the case of *Zonne v. Minneapolis Syndicate*, 220 U. S. 187, but I see quite a marked distinction between the two cases. It is true that in this case valuable property has been leased for a number of years, and that the companies, so far as that property is concerned, received royalties. In this respect they are similar to the *Zonne case*. But in the *Zonne case*, so far as the report of that case shows, the owner of the land had nothing to do with the management of the business. It had no supervision over the renting of the building and had no interest in supervising it. Here the evidence shows directly the contrary. It shows that under the terms of the lease the owners of this property have the right to inspect the work in the mines as it proceeds. It not only shows that the companies have that right, but it shows that they in fact exercised it and are exercising it. It shows that they are doing that for their own advantage, for the purpose of seeing that all the ore which is val-

nable and which the lessees are bound to take out, is taken out. This appears through all the testimony. It appears in the testimony of Mr. Bennett, and it appears in the resolutions adopted to settle the differences between the Oliver Mining Company and the Kearsage Land Company, with reference to the Glen mine; showing, in fact, that the lessors, so far from remaining idle and passive and doing nothing but receiving the rent which was paid to them, exercised constant watch and care over the operations of the lessees. They did that, and they must have done it necessarily, I assume, because the testimony is that they considered it for their advantage and profit to do so. If that were all that the evidence showed, I should say that this case was radically distinguished from the *Zonne case*, also radically distinguished from the *Nipissing case*, and from the *Minehill case*, because in no one of those cases did the lessor have anything whatever to do with the operation of the physical property. In all three of those cases the lessors simply received the money. They exercised no supervision over the management of the property, and had no right to do so, so far as the cases show.

But that is not all. The evidence shows that these three companies during each one of the three years were engaged in selling real estate, and, so far as those sales are concerned, they were not small. The Sargent Land Company's sales amounted to $4,624 in 1909, to $6,629 in 1910, and in 1911 they amounted to $3,385. That was engaging in

business, to my mind, it was selling real estate. They also did other things which have been referred to as being of such a light and trivial character as not to justify the court in holding that they constituted a doing of business, such as the sale of stumpage from some of the property which had been burned over, leasing some properties at Hibbing, and taking leases from squatters in order to more easily evict them. It is true that those matters were trivial, but they indicate that the companies were constantly supervising and caring for this property. It was their business, and in fact it was necessarily their business, because there was no one else to do it. They had to take care of that part of their property which was not leased, some one had to take care of it, and they did take care of it. There was evidence that the Kearsarge Company, in conducting the explorations in 1909, incurred an expense of $990 in test-pits. I assume that that was for the purpose of exploring the property to ascertain what its value was. It was an exploration of the so-called Pearce 40 to ascertain whether or not there was any more ore there. Under the head of inspection, the Sargent Company, in 1909, employed Longyear during explorations made by the Great Western Mining Company to take samples and classify them. I understand that the Great Western Mining Company was not engaged in mining operations, but it was simply exploring for itself, and the Sergeant Company supposed that it would be for its own benefit to know something about what was going on. All these things indi-

cate to my mind the doing of and engaging in business. It was doing the business of handling a large property, selling lots, and seeing that the lessees lived up to their contracts. If that is not engaging in business, I do not know what is. But it is said that it was not for any gain or profit. It is said that no company comes within the operation of this act unless it is organized for profit. I do not know that it is necessary to decide exactly what that means in this case, although my present opinion is that the words "organized for profit" are used to distinguish these corporations from charitable corporations; that any corporation organized by private persons for their own advantage and interest, and not for social, charitable or beneficent purposes, is organized for profit; and that a company organized as these companies were, to acquire title to an estate for the purpose of liquidating it and dividing the proceeds among the owners, is organized for profit, as that term is used in the act in question. And the persons who organized these companies evidently considered it so, because when the first articles were adopted they were drawn under the provisions of the Minnesota Statutes which related to companies organized for profit.

There was considerable evidence to show that the companies themselves did not engage in the business of selling lots, and did not themselves do the inspection, but that such work was done and the sales were made by other companies employed by them; that the Meriden Iron Company was em-

ployed to do the inspection, and that the E. J. Longyear Company was employed to sell the lots. The fact that they employed a company to do the selling on a commission, instead of having their treasurer or manager do it, does not relieve them from the charge of doing business. The same is true with regard to this inspection work. They might have employed Warren themselves to do this work, and if in so employing him they would be engaged in doing business, they certainly would be if they employed a company to do it. In fact, in the case of *McCoach v. Minehill & Schuylkill Haven R. R. Company*, which was decided on April 7th, 1913, by the United States Supreme Court, the court said:

> "From the facts as stated above, it is entirely clear that the Minehill Company was not, during the years of 1909 and 1910, engaged at all in the business of maintaining or operating a railroad, which was the prime object of its incorporation. This business, by the lease of 1896, it had turned over to the Reading Company. If that lease had been made without authorization of law, it may be that for some purposes, and possibly for the present purpose, the lessee might be deemed in law the agent of the lessor; or at least the lessor held estopped to deny such agency."

I do not, myself, think that the amendment of the articles of incorporation makes any difference, so far as this case is concerned. The original articles authorized the company to engage in the business of buying and selling real estate. The amended article provides as follows:

"The general purpose of the corporation is to unite in one ownership the undivided fractional interests of its various stockholders in lands, tenements and hereditaments, and to own such property, and, for the convenience of its stockholders, to receive, and distribute among them, the proceeds of any disposition of such property at such times, in such amounts, and in such manner, as the board of directors may determine."

It is true that the amendment specifically mentions only receipts of the proceeds, but it authorizes the corporation to own property. The power to sell the property so that the proceeds can be received, is necessarily implied by the article itself. The corporation owns the property; if it is to distribute the proceeds of a sale it must itself make the sale, for no one else can do it. This is the theory upon which the corporations have proceeded. Since the amendment the directors have taken care of the property, have sold some of it, and have done this in strict conformity with the amended article.

But this question, I think, has been decided by the case of *Mitchell v. Clark Iron Company*, 220 U. S. 107. The bill alleged in that case in effect, that the defendant Iron Company was the owner of the land described in the bill; that prior to the passage of the act in question it had leased the land; that it had done no business, except to watch over and care for said lands, and receive rents and royalties therefrom, and distribute the same among the stockholders, and such business as was necessary to defend the title. That was the allegation

upon which the case was decided. The evidence in this case does not show it in any more favorable light for the plaintiffs. Upon that allegation the Supreme Court decided that the company was doing business within the terms of the act. I must therefore decide that these companies were so doing business.

Reported with the case of *Flint v. Stone-Tracy Company* is the case of the *Fifty Associates*. On page 170 is said:

> "They are operating under a charter to own real estate, with power to build, improve, alter, pull down and rebuild, and to manage, exchange and dispose of the same."

That company was held to be doing business or engaged in business within the purpose of the act.

I have already referred to the case of *McCoach v. Minehill Railroad Company*, and the case of *United States v. Nipissing Mines Company*. As I have said before, I think that they are not controlling authorities in this case, and I have come to the conclusion that these companies were, during all the times named, engaged in business, so as to bring them within the operation of the act, and that it was their duty to make returns.

But the next question, and to my mind the important question, is whether or not the sums of money which were received by the companies during these years as royalties and on the sales of lots were gross income within the meaning of the act. It appears from the evidence that the collector treated the gross receipts of the companies

as "gross income." The question of what income was, or what depreciation was, was not raised in the case of *Mitchell v. Clark Iron Company*, and it was not raised in any of the cases decided at the time the case of *Flint v. Stone-Tracy Company* was decided. The only question there, as I understand it, was whether the companies were bound to make returns. The words depreciation and what it means in this act are to my mind not vitally important here. I do not base my decision upon the meaning of that word, nor upon its use in the act, but rather upon the meaning which should be given to the words gross income. Those are the words used in the act, together with the words "net income" and "earnings." The words gross receipts were not used in this act, as they were in the case of the *Spreckles Sugar Refining Co. v. McLain*, 192 U. S. 397, nor are the words used here "deposits," as was the word used in *Society for Savings v. Coite*, 6 Wall. 594. What was intended by the use of the words gross income? What does the word income mean? In ordinary speech people recognize a difference between capital and income. I believe that the ordinary meaning attached to income, when it is not derived from personal exertion, is that it is something produced by capital without impairing that capital, and which leaves the property intact, and that nothing can be called income for the purpose of this act which takes away from the property itself. If it does, then it ceases to be income, and amounts to a sale of capital assets. This definition of the word income I think

is deducible from what was said in *Flint v. Stone-Tracy Company*, although it is not so distinctly stated. On page 146 the court said:

> "The income is not limited to such as is received from property used in the business, strictly speaking."

That necessarily means that the property itself remains in the business, and continues to be used in the business, and that income was something that was derived from the use of it, leaving the property intact. On page 165 the court said:

> "It is no objection that the measure of taxation is found in the income produced in part from property which of itself is considered non-taxable."

It is important to notice that in that connection the court was speaking of government bonds, which are not taxable. Income derived from government bonds is money derived from them without impairing the capital which produced it.

It follows necessarily from the views which I have expressed, that the words "gross income" do not mean "gross receipts." It is apparent to me that gross income cannot mean gross receipts. Take, for example, the case of a mercantile corporation. It has property at the beginning of the year worth $100,060. During the year it sells at retail $10,000 of that property at what it cost. Then in the last month of the year, in December, it sells the entire property which it has left for $90,000, so that its gross receipts for the year are $100,000. It cannot be possible that such a cor-

poration is bound to pay this tax on $100,000. Having sold $10,000 at no profit, it ought not to be subject to any taxation on that. As to the $90,000, that is money derived from a sale of capital assets. It is simply a change in the form of the capital; the merchandise has become money. If that $90,000 is taxable under this act, it can only be on the theory that Congress intended to put a tax upon the transfer of property. I do not doubt the power of Congress to do that, but when the court decided in the *Flint case* that this was a tax upon the privilege of doing business in a corporate capacity, it expressly decided that it was not a tax upon the transfer of property. I will refer again to the illustration which I have given. I will modify it by assuming that the corporation sold the $90,000 in question for $80,000; that is, that the merchandise cost it $90,000 and it sold it for $80,000. That $80,000 must figure in its gross receipts for that year. But it lost $10,000 during the year, instead of making $90,000. It is perfectly apparent from the language of the act, that it was never the intention of Congress to impose a tax upon a corporation that was not making money; it was never its intention to tax a losing business.

Coming to the regulations made by the commissioner of internal revenue, it will be noticed that the words "gross receipts" are nowhere used in the act or in the regulations. On the contrary, the following statement is found in Article 2, Section 5:

"It will be noted from these definitions that gross income is practically the same as gross profits."

An examination of the rules given for the determination of the gross income of different kinds of corporations shows that it was never in the mind of the commissioner to make the gross receipts the foundation for a determination of the gross income.

In the same Article 2, Sec. 5, there is found the following:

"Sale of capital assets. In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income according to whether the selling price was greater or less than the buying price. If the capital assets were acquired prior to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which proportion shall be deducted from or added to the gross income for the year in which the sale was made."

This indicates that it is not money derived from capital that is to be taxed, but only that part of it which can be in some manner determined to be profits.

That this ore in place is capital, and is part of the real estate, I think admits of no question. It is just as much a part of the real estate as trees

standing on the land.

Let us suppose that John S. Pillsbury & Company, when it owned this land with the timber still standing thereon, was a corporation; that in 1908 it sold the timber with the privilege of removing it within ten years, and that in 1909, 1910 and 1911 the purchaser cut the timber and during these years paid the purchase price of it. Could it be said that the purchase price so received was income within the meaning of this act? I do not think that it could. It was not income, it was the property itself; and, as I said before, the trees standing on the land are no more a part of the realty than is the ore under the surface of the land. They are both capital, and money derived from a sale thereof cannot be considered income, whether it be money received from the ore, or money received from the timber.

There are two cases, and only two, to which my attention has been called, that have passed upon this question; one is *United States v. Nipissing Mines Company*, 202 Fed. 803, where the conclusion was reached that money thus received was not income; and the other is *Stratton's Independence v. Howbert*, decided in the District Court of Colorado. Of the cases cited in the opinion, only two had to do with the question of taxation.

In *King v. Attwood*, 6 Barn. & Cres. 277, Attwood was the owner of a coal mine and was assessed on a rate for the relief of the poor. But the act there construed (43 Eliz. c. 2) specifically made owners of coal mines rateable.

The same is true in *Coltness Iron Company v. Black*, 6 Law Rep. Appeal Cases, 315. Moreover, in that case it was said:

> "The intention of the act, it is abundantly clear, was, in Schedule A, to tax 'property.' If a man had bought an estate, the tax was intended to be paid by him on the annual value of that estate, without reference to where he got it, or how he got it, or how much he paid for it. So if a man built a house or bought a house, he was intended to pay tax on the annual value of the house, no matter what it cost. Nor does anything turn upon the fact that the estate is a permanent and undecaying species of property while the house is a species of property of a less durable kind. He was intended to pay the tax upon it as long as it lasted.
>
> "What, then, is the case of a mine? In the Schedule A, which is the schedule applicable to 'property,' a 'mine' is in express terms included as a species of 'property,' and is made the subject of a tax."

I attach no importance to the fact that the company used the word dividends in making this distribution. If the money was not gross income, the fact that when they distributed it they called it dividends, could not in any sense change the law as to what the real character of the money was. Nor do I attach any importance to the fact that upon the books the company carried no "depreciation" account.

I come now to the decision of the commissioner, which has been read by the district attorney as a part of his argument. It seems to be based upon the theory that when the Sargent Company, for

example, was organized in 1906, it bought the property for $108,000; that it was then worth much more than that sum; that this excess is being received annually by way of royalties, and that the portions received in 1909, 1910 and 1911 must be considered as profits, and therefore income to be taxed. The commissioner seems to have made an attempt to apply to the case that part of the regulations heretofore quoted under the heading "Sale of Capital Assets." This property was all acquired prior to January 1, 1909. In applying the rule, it is necessary for him to determine the proportion of the gain which arose subsequent to that date. There is no evidence to show what the value of this property was at any time before the incorporation, or at any time since. Yet it clearly appears that there has been no gain at all, so far as these plaintiffs are concerned, since 1909. All of the leases were made prior to that date for terms of 50 years or more. The value of the property to the plaintiffs was then fixed, and it could not be changed to their advantage during the terms of the leases. In other words, the property was worth no more to them in 1909, 1910 and 1911 than it was in 1906, 1907 and 1908.

The regulation relating to income from sale of capital assets is therefore by its terms applicable to this case.

But the assumption that there was any profit even in 1906 is entirely unwarranted. The only basis for that assumption is the fact that the Sargent Company was organized with a capital stock

of $108,000, which it issued for the land conveyed to it, and that the land is now worth much more than that amount. It will be noticed that the amount of the capital stock was fixed at $108,000, because the smallest interest which any owner of the property had was one-one hundred and eighth part of the whole. It is perfectly apparent from the evidence that $108,000 was selected as the value of the capital without any reference whatever to the value of the property. The value of the property was not then considered, and it is apparent that it could not have been, because at that time all the leases had been made, and it was then known that the value of the property was largely in excess of $108,000.

It is evident that taking $108,000 as the capital stock was a mere nominal capitalization, without reference to value. It comes very near in substance, as I thought when I heard the evidence, to a corporation with shares without par value, such as are allowed now by the laws of New York, as I understand.

Take the illustration which I gave when Mr. Houpt was presenting his side of the case, a bridge company capitalized for $10,000 when the property itself cost a million dollars. Manifestly, it would be most unjust to say, for the purpose of taxing the company under the act, that it had made the difference between $10,000 and cost of the bridge, simply because it had selected $10,000 as the amount of its capital stock. That sum was selected for its own convenience, without any refer-

ence whatever to the value of the property. If the Sargent Company had selected $108,000,000 as the amount of its capital stock instead of $108,000, would these receipts be taxable under this act? Evidently not, according to the theory of the commissioner.

This case is to be decided upon what the actual facts are, and not upon what they appear to be. The actual facts are that nobody has made a dollar out of these properties by these incorporations. The evidence shows that the same persons own the stock now who owned the property before the corporations were organized. The mere change of form of ownership from that of these individuals to that of a corporation owned by the same individuals cannot produce such large profits as are claimed here.

The only conclusion that I can come to on this branch of the case is, that this money was never received as gross income, and cannot be in any sense called income; that it was never taxable, and that the tax on it was wrongfully collected. I assume that there is no question about the amount, so that judgments can be rendered for the amounts claimed in the complaints.

I do not propose to make special findings of fact. I shall make a general finding in each one of the cases for the plaintiff, and will order judgment for the amount claimed. I think, Mr. Houpt, that you should make some requests for declarations of law.

Mr. Houpt: I would rather except to the ruling of the court holding that the receipt of royalties,

as shown in this case, does not constitute gross income.

The Court: Note an exception.

In the Supreme Court of the United States.

OCTOBER TERM, 1913.

No. 457.

STRATTON'S INDEPENDENCE, LIMITED,

vs.

F. W. HOWBERT, COLLECTOR OF INTERNAL REVENUE WITHIN AND FOR THE DISTRICT OF COLORADO.

On Certificate from the United States Circuit Court of Appeals for the Eighth Circuit.

BRIEF OF *AMICI CURIAE.*

There is now pending in the District Court of the United States within and for the District of Colorado an action at law, being No. 6117 on the docket of said court, entitled, Camp Bird, Limited, plaintiff, vs. Frank W. Howbert, as Collector of Internal Revenue for the District of Colorado, defendant. The complaint in this action was filed on August 22, 1913. In this action suit is brought by the plaintiff against the defendant to recover the sum of $35,851.10, paid under protest, as additional taxes for the years 1909, 1910, and 1911.

In each of these years the plaintiff, Camp Bird, Limited, made return to the defendant, as internal revenue collector for the District of Colorado, in conformity with section 38 of the act of Congress approved August 5, 1909, relating to excise tax on corporations, and subsequently the commissioner of internal revenue of the United States assessed an excise tax on the net income of the plaintiff for said years, and certified the same to the collector of internal revenue for the District of Colorado, who collected the tax from Camp Bird, Limited.

Subsequently to the paying of all of these taxes, and on or about the 5th day of August, 1912, the commissioner of internal revenue of the United States assessed an *additional* excise tax against Camp Bird, Limited, upon its income for the calendar years 1909, 1910, and 1911, amounting in all to $34,173.10, and certified the same to the collector, who, about the 12th day of August, 1912, notified the plaintiff and demanded payment thereof, and at the same time notified the plaintiff that, unless the same was paid within ten days after such demand, he would proceed to collect the same, with a penalty of 5 per cent additional, and with interest thereon at the rate of 1 per cent per month. Thereupon plaintiff filed with the collector and with the commissioner claims and applications for the abatement of the additional taxes so assessed against it, wherein were set forth in detail the grounds on which plaintiff claims that such additional assessments were illegal, unjust, discriminatory, and void. These applications and claims for abatement were, on January 13, 1913, rejected by the commissioner, and the plaintiff was ordered to pay

the additional taxes, with interest from September 22, 1912, and a penalty of 5 per cent in addition if the sums were not paid prior to January 27, 1913, and with the threat that the plaintiff's property would be distrained and sold by the defendant in satisfaction of such taxes, interest, and penalty, in case of its noncompliance with such demand. On January 22, 1913, Camp Bird, Limited, in order to prevent the sacrifice of its property by distraint and sale, paid under protest to the collector the amounts required, and afterwards filed the aforesaid action to recover back these amounts.

The action of the commissioner of internal revenue in requiring Camp Bird, Limited, to pay the additional tax was based on the fact that Camp Bird, Limited, had deducted from its gross income the net amount of depreciation of the value of its property for those years. It had taken the value of its property as calculated from close and careful surveys of the ore bodies therein contained as of the beginning and end of the year, and the loss in the value of the ore reserves in the mine (together with that of the buildings and other equipment of the property) was regarded as "depreciation," and deduction from the amount of its income was claimed accordingly. The annual surveys or inventories of the ore bodies of the mine are carefully made for the purpose of determining, for the benefit of the stockholders, the exact condition, value, and probable life of the property, and appear in detail in books of the company especially kept for that purpose. The commissioner refused to permit the amount of decrease of the value of the ore reserves, or any part thereof, to be deducted from the

gross income of the company. It is not questioned by the commissioner, we believe, that the actual amount of ore exposed in the mine did decrease in the years stated in the amounts set forth in the returns of the plaintiff, although it has been stated by him that such depreciation should not be allowed unless it appears on the company's ledger as a charge against its capital, whereby its capital would be reduced equal to the amount of depreciation claimed. However, the deduction was not rejected on that ground, nor do we believe that ground is tenable, as the statute makes no such requirement.

There was some question between the company and the commissioner as to the depreciable value of the property—that is to say, the maximum amount which might eventually be written off as depreciation—the commissioner contending that this value was to be arrived at on the basis of the original cost of the property to the plaintiff, from which its subsequent production of ore up to January 1, 1909 (the date the law went into effect), might be deducted, while the company contended that the depreciable value is to be fixed by the inventory or survey of the ore bodies known to exist in the mine on January 1, 1909, irrespective of the cost of the property or its output prior to that time. That is to say, the amount of depreciation which the company might claim in subsequent years under the act was not based upon the purchase price of the property, which was fixed years before, but upon its actual inventory value of the date the act went into effect. Although the commissioner refused to allow any depreciation, this question of depreciable value is not merely an academic one, as will be seen further on in this brief.

If the contentions made by Stratton's Independence, in the case at bar, shall prevail, and the law of 1908 be held not applicable to the ouput of mining corporations, Camp Bird, Limited, will recover from the collector the amount of additional taxes paid by it under protest. It adopts, therefore, *in toto*, the argument made by the able counsel for Stratton's Independence, Limited, in the case at bar. This argument it believes to be unanswerable. Nevertheless, as the facts in its case differ somewhat from those in the case at bar, it desires to present certain propositions for the consideration of this court which are applicable to its case, but not to the case at bar, in order that the court may be fully advised of other litigation which is now pending, based on the same act of Congress, presenting somewhat different controversies, and that it may not unintentionally prejudice such other cases.

The question presented in the case at bar is: Are the proceeds of ores extracted by mining corporations income subject to tax under the income-tax law? We desire to discuss a somewhat narrower question, which will be included in the answer to the broader question if that answer is negative, but which will still be open if this court decides that such proceeds are income. The question then arises: If they are income, to what extent is the mining corporation required to pay taxes on them? If this court should hold that the proceeds of ores extracted by mining corporations are included in income, within the meaning of the statute, it must remember that it is not necessarily the net amount of income on which the tax is required to be paid. So far as the Stratton's case is concerned, this distinction may be disregarded; but in the Camp Bird case it is

very important, as that corporation is not obliged, as we have above stated, to rest on the propositions that the proceeds of its ores do not constitute income, and that the ore extracted exactly offsets the income derived from the sale thereof, but can also assert that, even if that be true, yet it is entitled to have the decrease in the value of its property offset against its income, not to the full amount of the income, but only to the extent that the ore bodies in the mine are reduced in value, new ore bodies opened up being offset *pro tanto* against old ore bodies exhausted.

We do not wish to be understood as waiving to any degree the contentions made by Stratton's Independence, Limited, that the excise tax is inapplicable to mining corporations; that the proceeds of ores extracted by mining corporations are not income within the meaning of the statute, and that the ore extracted is depreciation exactly equal to the amount of income derived from the sale thereof. We believe these propositions are sound, and the arguments presented in the brief of Stratton's Independence, Limited, in support of them are unassailable. For this reason we do not think it necessary to present any further argument thereon. Our only desire is that certain less radical propositions and arguments, sufficient to support the contention of Camp Bird, Limited, may be presented to this court.

A mining corporation is different from all other corporations, in that it lives on its own body: its income is derived from conversion of its capital; it exhausts its property without possibility of repair or renewal. Strictly speaking, a mining corporation has no income at all; it is like a man who owns property.

real or personal, of which he sells a portion every year to live on. If he had sold his property and invested the proceeds in interest-bearing securities, he would have maintained his principal intact and had an income. But if the income he would have derived from interest on his securities was insufficient for his needs, he would be required, as illustrated above, to live on his principal. So, too, in the case of a mining property. If the amount of money invested in it had been used to purchase investment securities, or a manufacturing or mercantile business, an income would have been derived therefrom. But the investment was made in mines because a larger profit is derived therefrom, and this profit is larger because it means the exhaustion of the property and the reduction of the capital. Of course, if only the same total profits were made in the long run from mines as from manufactories, it would be short sighted policy to live on one's capital instead of one's income; but there is always the chance of uncovering new and hitherto unknown ore bodies, and thereby increasing the profits on the capital invested.

While the foregoing argument presents no legal difficulty, there is a practical difficulty that may appeal to the court. If the court should adopt that contention, mining corporations would escape payment of all income taxes, in spite of the fact that many of them have made enormous profits. It may be held that, even though mining companies are exhausting the *corpus* of their estates, it would be unjust and discriminatory to release them from all obligation to pay a tax which is assessed against all other corporations. Without waiving in any degree our insistence

that income of a mining company is not properly income at all within the terms of the income-tax law, yet we venture to suggest an alternative method of determining the income of a mining company, which is, we believe, free from the practical objection stated above.

The income of a mining property is the proceeds from the sale of ore. Against this, however, should be set off the depreciation in the value of the mine, if any. What is this depreciation? If the ore bodies in the mine at the beginning of the year were worth so much, and at the end of the year the ore bodies were so much less, that decrease in their value is depreciation. If a decrease in the value of the property is shown, the company should be allowed to offset it against the income it has derived from the property. In other words, the income of the corporation is its earnings from the sale of its product, less the difference in the corporation's stock in trade—i. e., its ore bodies.

A mine is peculiar in this respect; what its true value is cannot be known. No one can see into the ground. Experts, however, have arrived at methods of determining values of mines which approximate their true value. The mine is developed to such an extent as is practicable under the circumstances, and the engineers who are examining the property measure and calculate the value of the "ore in sight" (which term explains itself), the "probable ore," and the "possible ore," basing their valuation in the case of the two latter on the degree of probability or possibility of further ore bodies as determined by their judgment. This examination of a mine is similar to

the inventory made by a mercantile concern, and is made for the same purpose. It is only by making such an inventory or examination that the company can tell with any degree of exactness what the value of the property is, and whether it is increasing or decreasing.

As we have stated, no one can see what is in the ground. But if a careful inventory is made each year and the same methods employed, a valuation can be reached which, if not the true valuation (because that can never be known), is such a valuation as is universally adopted by vendors and vendees of such properties. It is the best possible method of arriving at the value of the property.

If the ore bodies in a mine are worth $1,000,000 on January 1, and $900,000 on the first of the succeeding January, then that property is worth $100,000 less on the later date than on the earlier, and should be allowed as depreciation as much as any other kind of depreciation, if not more so.

But it may be objected that no provision is made in case the value of the ore reserves in the mine increases during the year. In that case, in our opinion, as the inventory value of the property is increased, the company should be required to pay the tax on the amount of such increase, the same as a mercantile establishment is required to do.

The above method of determining the income and depreciation of mining corporations is practically the same as that adopted by the commissioner of internal revenue in regard to other corporations, and set forth in the "Laws and Regulations Relative to Excise Tax on Corporations," of December 3, 1909.

The provisions regarding gross income, to which we desire to call the court's attention, are sections 3, 4, and part of 5, Article II, as follows:

> "3. *Manufacturing companies.*—Gross income received during the year from all sources will consist of the total amount, ascertained through an accounting, that shows the difference between the price received for the goods as sold and the cost of such goods as manufactured. The cost of goods manufactured shall be ascertained by an addition of a charge to the account of the cost of goods as manufactured during the year of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year. To this amount should be added all items of income received during the year from other sources, including dividends received on stock of other corporations, joint stock companies, associations, and insurance companies subject to this tax. In the determination of the cost of goods manufactured and sold as above such cost shall comprehend all charges for maintenance and operation of manufacturing plant, but shall not embrace allowances for depreciation of property nor for losses sustained which are to be taken account of in ascertaining the net income subject to tax under the proper heading in the authorized deductions.
>
> 4. *Mercantile companies.*—Gross amount of income received during the year

from all sources consists of the total amount ascertained through inventory, or its equivalent, which shows the difference between the price received for goods sold and the cost of goods purchased during the year, with an addition of a charge to the account of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year. To this amount should be added all items of income received during the year from other sources, inclusive of dividends received on stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax. In determining this amount no account shall be taken of allowances for depreciation of property, nor for losses sustained which are to be taken account of in ascertaining the net income subject to tax under the proper heading in the authorized deductions.

5. *Miscellaneous.*— * * * It will be noted from these definitions that gross income is practically the same as gross profits, the only difference being that gross income is more inclusive, embracing as it does not only gross profits of the corporation, joint-stock company and association itself, but also all amounts of income received from other sources. It is immaterial whether any item of gross income is evidenced by cash receipts during the year or in such other manner as to entitle it to proper entry on the

books of the corporation from January 1 to December 31 for the year in which return is made."

And the provisions regarding depreciation are found in Article IV, as follows:

"*Depreciation.* The deduction for depreciation should be the estimated amount of the loss, accrued during the year to which the return relates, in the value of the property in respect of which such deduction is claimed that arises from exhaustion, wear and tear, or obsolescence out of the uses to which the property is put, and which loss has not been made good by payments for ordinary maintenance and repairs deducted under the heading of expenses of maintenance and operation or in the ascertainment of gross income. This estimate should be formed upon the assumed life of the property, its cost value, and its use. Expenses paid in any one year in making good exhaustion, wear and tear, or obsolescence in respect of which any deduction for depreciation is claimed must not be included in the deduction for expense of maintenance and operation of the property or in the ascertainment of gross income, but must be made out of accumulative allowances deducted for depreciation in current and previous years."

There is no specific provision for mining companies.

The statute itself provides:

> "That every corporation * * * shall be subject to pay annually a special excise tax * * * upon the entire net income over and above $5000. * * * Such net income shall be ascertained by deducting from the gross amount of the income * * * (second) all losses actually sustained * * * including a reasonable allowance for depreciation of property if any."
>
> Sec. 38 of the act of August 5, 1909.

Mr. Arthur W. Machen, Jr., author of the Modern Law of Corporations, says in his work on the Income Tax Law:

> "Sec. 57. *Depreciation of Property.*—The importance of the provision as to depreciation of property has been already adverted to. It evidently covers depreciation of all kinds—by wear and tear, by the diminution in value of wasting assets such as mines, leases or patents, or in consequence of supersession by improved apparatus, and in fact diminution of all kinds. But for this express provision it might have been plausibly argued and perhaps would have been held, that a depreciation in the value of a company's fixed capital does not in any way diminish the net income.* It is only depreciation within the year that is required to be deducted; this is

* This is true under the English law [citing cases].

> the only reasonable meaning of the statute, and is expressly declared by the Commissioner of Internal Revenue in his published regulations.† However, all depreciation within the year must be allowed notwithstanding the fact that in previous years allowances for depreciation or wear and tear aggregating the full value of the property may have been made to the company.‡"

We contend that the Commissioner's ruling that no depreciation can be allowed on account of loss in value of ore bodies cannot be sustained, as it is clearly contrary to the provisions of the statute, which expressly declares that "a reasonable allowance for depreciation of property if any" shall be deducted from the gross amount of income of the corporation. It is clear that some depreciation must be allowed, as the act expressly so provides. The former Income Tax Law enacted August 15, 1894, and declared unconstitutional by this court in Pollock vs. Farmers Loan & Trust Co., 157 U. S. 429, contained no such provision, and the inclusion of this clause in the present act connotes the intent of Congress to provide an allowance for depreciation. The only question is what is a reasonable amount of depreciation. If all the proceeds from the sale of ore is not depreciation, is not the method we have suggested for determining what reasonable depreciation is the only logical one?

We submit there is nothing in the commissioner's contention that depreciation should be charged off on

† U. S. Int. Rev. Regs. No. 31, Dec. 3, 1909, Art. 4 [quoted elsewhere].

‡ John Hall, Jr., & Co. v. Rickman (1906) 1 K. B., 311.

A Treatise on the Federal Corporation Tax Law of 1909, by Arthur W. Machen, Jr., p. 73.

the general books of the company if it is to be allowed as an offset. Indeed we are informed that even where this has been done by certain companies in response to this suggestion of the commissioner, he has refused to make the allowance. So that he has probably abandoned this contention. But at any rate there is no such requirement in the Act of Congress.

On January 1, 1909, the date the law went into effect, the ore reserves in the Camp Bird Mine were of the value of about $3,100,000. During the year the company derived about $2,950,000 from the sale of ores taken from the mine and other sources; its expenses, taxes, etc., deductible under the statute, were $1,300,000. The ore reserves on January 1, 1910, were $1,600,000 (on account of new discoveries the ore reserves were not reduced to the full amount of the output of the mine), or $1,500,000 less than at the beginning of the year. There was also depreciation in the value of the mills, machinery, tramways, etc., which, taken with the depreciation in the ore reserves, more than offset the income of the company. A return was made to the commissioner of internal revenue, showing a deficit instead of a net income on which taxes could be assessed. Two years and six months later the commissioner notified the company that he had made an additional assessment against it for the year 1909 of $20,126.81 (being 1 per cent on $2,012,681). The principal difference between the commissioner and the company, and the only one material to this controversy, is whether the decrease in the value of the ore reserves is deductible as depreciation from the income of the company subject to taxation.

For the year 1910 the company reported a net income of about $318,000, paid the tax thereon, and one year and six months later was notified of an additional assessment of $7,295.96. For 1911 the company reported and paid the tax on $136,000, and six months later was notified that $6,750.33 additional had been assessed against it.

In order that this court may be fully advised, we will say that the tax on $550,000 in 1909 and $108,000 in 1910 is in dispute between the commissioner and the company, the question being whether the amount of income should be charged to the company or to Mr. Thomas F. Walsh, from whom the company acquired the property. That question has nothing to do with this controversy, but is merely one of fact as to who owned the ores from the proceeds of which the income was derived. If the commissioner's contention is sustained, the company's income for 1909 would be about $175,000; for 1910, $126,000, and for 1911, $136,000; that amount remaining unchanged, as there was no Walsh ore involved.

The Camp Bird Mine was bought by its present owners from Mr. Walsh in 1902. It has been a very fine producer, paying in years past large dividends; but since 1908 the depreciation in the value of its ore reserves has been very rapid, and today it is practically a worked-out mine. On June 30, 1912, it was figured by the engineers of the company that there was not over $300,000 profit in the ores then exposed in the mine.

The question of depreciation is, therefore, a very material one to this company. Its mine is almost

worked out; there are practically no ore reserves. It has expected at any time within the past two years that it might be compelled to close down for lack of ore. There are many other mines in the same condition in the United States; and, indeed, all mines must reach this condition in time; so that the question we present as *amici curiae* is not one that should be answered only for the benefit of Camp Bird, Limited.

The construction we urge is not one that can be adopted in the case of depreciating mines, however. It is applicable to mines of all conditions. It is the most logical and fairest method of assessing mining properties, if the proceeds of their ores are to be taxed at all.

If, therefore, the court shall hold that the proceeds of the sale of ore from a mine is income and taxable within the meaning of the income-tax law, then we contend that in such case the proper construction to be given to the law is that we have set forth herein, and which is the same construction the commissioner of internal revenue has adopted in the case of manufacturing and mercantile corporations. We contend that such construction conforms with the spirit of the act as well as its letter, and that it does justice, not only to the mining company, but also to the United States. It requires the mining companies which are in receipt of large incomes, and whose properties are not becoming exhausted equally or more rapidly, to pay taxes, while companies which own mines whose inventories show a decreasing valuation are released from taxes to the extent of that decrease,

so long as it does not exceed the depreciable value of the property.

Respectfully submitted.

CHARLES S. THOMAS,
W. H. BRYANT,
GEORGE L. NYE,
WM. P. MALBURN,
WILLIAM STORY,
WILLIAM STORY, JR.,
Amici Curiae.

Supreme Court of the United States.

OCTOBER TERM, 1913. No. 457.

STRATTON'S INDEPENDENCE, LIMITED,
Plaintiff-in-error,

v.

F. W. HOWBERT, Collector of Internal Revenue,
Defendant.

TO THE HONORABLE THE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petition of William D. Guthrie respectfully shows:

That your petitioner is an attorney and counsellor-at-law duly admitted to practise in this court; that he has been retained by the Utah Copper Company, a New Jersey corporation, owning a large mining property in the State of Utah, and by other mine owning corporations, to advise them and represent their interests in the subject matter involved in the above entitled cause, and that petitioner believes that the interests of said mine owners will be materially affected by the decision of said cause.

That he is informed by his clients and believes that said mine owning corporations have paid under protest the amount of the tax assessed against them under and by virtue of section 38 of the Act of Congress of August 5, 1909 (36 Stat. 112, c. 6).

WHEREFORE your petitioner prays that the court grant him leave to file the accompanying brief in the above entitled cause.

New York, October 10, 1913.

William Guthrie
Petitioner

UNITED STATES OF AMERICA, } ss:
Southern District of New York, }

WILLIAM D. GUTHRIE, being duly sworn, deposes and says: I am the petitioner named in the foregoing petition I have read the same and know the contents thereof, and the same is true of my own knowledge, except as to the matters therein stated to be alleged on information and belief, and as to those matters I believe it to be true.

WILLIAM D. GUTHRIE.

Sworn to before me this 10th }
day of October, 1913. }

BERNARD HERSHKOFF,
Notary Public,
New York County, N. Y

[Impressed Seal]

Supreme Court of the United States,

OCTOBER TERM, 1913.

No. 157

STRATTON'S INDEPENDENCE, LIMITED,
Plaintiff in error

v.

F. W. HOWBERT, Collector of Internal Revenue,
Defendant

ON A CERTIFICATE FROM THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF OF WILLIAM D. GUTHRIE AS AMICUS CURIÆ.

INDEX.

TABLE OF CASES.

Supreme Court of the United States.

OCTOBER TERM, 1912. No. [illegible]

STRATTON'S INDEPENDENCE, LIMITED,
Plaintiff in error,

v.

J. W. HOWBERT, Collector of Internal Revenue,
Defendant in error.

BRIEF BY AMICUS CURIÆ.

This brief is submitted on behalf of mine owners whose interests may be materially affected by the determination of the questions involved in the above entitled case. In it will be discussed two questions as to the meaning and intent of section 38 of the Act of Congress, approved August 5, 1909 (36 Stat. 11, c. 6), viz:

(1) Whether ore in place belonging to mining corporations should be treated as income or as capital; and

(2) Whether the value in place of ore that has been extracted from a mining property during a given year is properly chargeable as depreciation in estimating the net income of a mining corporation for the purposes of taxation under said Act of Congress.

Section 38 of the Act of August 5, 1909 (36 Stat. 112, c. 6), so far as material, provides as follows:

> "That every corporation organized for profit and having a capital stock represented by shares shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation equivalent

to one per centum upon the entire net income over and above five thousand dollars received by it from all sources during such year. . . . .

"Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation . . . received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of the property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any . . . (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid up capital stock of such corporation . . . . outstanding at the close of the year . . . . (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the government of any foreign country as a condition to carrying on business therein; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed."

I.

THE CAPITAL OF THE ORDINARY MINING CORPORATION NECESSARILY INCLUDES THE ORE IN PLACE.

The capital of an ordinary mining company is its mine and plant. If a mining company owns the parcel of real estate on which its mine is located, it is perfectly plain that such real estate is part of its capital, and as it includes and embodies the sum total of the ore, it follows that the

ore in place—and every part of the ore in place—must be deemed capital.

If a mining company should sell its land and the mine on it, it would plainly be transferring not income but capital; and it would be wholly immaterial whether the sale was at an advance, since not even the advance would constitute income (*Gray* v. *Darlington*, 15 Wall. 63, 66; Machen on The Federal Corporation Tax Law, secs. 31, 35). As Mr Justice Field said in *Gray* v. *Darlington*, "mere advance in value in no sense constitutes the gains, profits, or income specified by the statute [taxing annual income, but] constitutes and can be treated merely as increase of capital." The character of ore in place is not changed from capital to income by the fact that it may be mined and milled and sold in a somewhat manufactured state. If the ore in place was capital before it was mined, it would seem that that which is substituted therefor in the process of mining should equally with the ore itself constitute a capital asset.

But it is insisted that the ore in largest part consists of income, because it is the source of the dividends which the mining company declares; and dividends, it is argued, may not be paid by a corporation out of capital but only out of income. This argument is more plausible than sound. The contention fails to observe the inherent difference between ordinary mercantile corporations, to which this reasoning would apply, and mining corporations, to which it does not apply.

An ordinary business corporation contemplates the maintenance and preservation of its fixed capital in a practically undiminished condition throughout the entire period of the corporate existence, and it is upon that im-

plied understanding that creditors (the persons for whose protection this rule is primarily intended) and stockholders rely in their dealings with the company. It would, therefore, be a fraud upon creditors for such a corporation to pay a dividend out of its capital, which is sometimes called a trust fund.

But a mining corporation is a corporation of an entirely different kind. It is usually formed to exploit a particular mine or group of mines, and its operations must necessarily deplete the ore deposits and thus consume or waste the capital. It is not and cannot be intended that its capital shall be permanently maintained. Creditors and stockholders are presumed to be aware of that fact and to make loans, give credit or buy stock with that fact in view. It is, therefore, no violation of anyone's rights for a mining corporation, after it has paid its operating expenses and made proper provision for creditors and contingencies, to distribute the balance of its receipts among the stockholders as dividends. (4 Thompson on Corporations, 2nd ed., sec. 5322; 1 Morawetz on Corporations, 2nd ed., sec. 442; *Lee v. Neuchatel Asphalte Co.*, L. R. 41 Ch. D. 1; *Excelsior Water and Mining Co. v. Pierce*, 90 Cal. 131; White on Canadian Company Law, p. 98.) But it does not follow that such dividends consist of income. As matter of fact, they consist of capital. This was recognized in the leading case of *Lee v. Neuchatel Asphalte Co.*, L. R. 41 Ch. D. 1, 24, where Lord Justice Lindley spoke as follows:

> "Now we come to consider how the *Companies Act* is to be applied to the case of a wasting property. If a company is formed to acquire and work a property of a wasting nature, for example, a mine, a quarry, or a patent, the capital expended in acquiring the property may be regarded as sunk and gone,

and if the company retains assets sufficient to pay its debts, it appears to me that there is nothing whatever in the Act to prevent any excess of money obtained by working the property over the cost of working it, from being divided amongst the shareholders, and this in my opinion is true although some portion of the property itself is sold, and in some sense the capital is thereby diminished. *If it is said that such a course involves payment of dividend out of capital, the answer is that the Act nowhere forbids such a payment as is here supposed.* The fact is, you cannot get out of the Act any prohibition against paying dividends out of capital except by laying reference to the general principle to which I have alluded, and which general principles cannot be stretched, to my mind, to such a length as Mr. *Rigby* invites the Court to stretch them.

It would, of course, be entirely proper for a corporation which had made adequate provision for its creditors to reduce its capital stock and distribute among its stockholders the surplus of its capital over and above the amount of the reduced capital stock (1 Thompson on Corporations, 2nd ed., sec. 2057), but such a distribution, though termed a dividend, would be of capital and not income. A mining corporation occupies an analogous position. It is permitted by law to distribute its capital among its shareholders as its operations go forward, so long as it protects its creditors, but it is freed from the necessity of periodically reducing its nominal capital stock, because, by virtue of the very nature of the business, its nominal share capital can rarely furnish any indication of its actual capital, and hence no useful purpose would be served by changing the nominal capital from one amount to another. *Re South Mountain, &c., Mining Co.*, 7 Sawy. 30, 32; 5 Sawy. 300; 2 Morawetz on Corporations (2nd ed.), sec.

830. In other words, a mining company is authorized to distribute its capital in dividends, not because such capital has been transmuted into income, but because its capital does not constitute a fund which it must retain and keep equivalent to the nominal amount of its share capital. 4 Thompson on Corporations (2nd ed.), sec. 3017. It is, therefore, futile to rely upon such decisions as *Lee v. Neuchatel Asphalte Co.* and *Excelsior Water and Mining Co. v. Pierce* as establishing that ore in place in a mine constitutes anything other than capital.

Nor does the case of *People ex rel. U. V. Copper Co. v. Roberts*, 156 N. Y. 585, afford support to that proposition. There it appeared that the mining company had passed a number of dividends and had accumulated a surplus. If this fund was in fact surplus, it was not taxable; but it was argued that "as the mines had been worked ever since 1883, the ore extracted and sold and large dividends paid, they were necessarily to some extent depleted and exhausted and the capital stock of relator impaired, so that no surplus as matter of law could be accumulated." (156 N. Y. 590.) This contention was overruled, and rightly so, because there is no duty upon a mining company to make good the depreciation which its working of the mine entails, and hence it may lawfully have, and in that case did have, a large surplus, although its mine was to some extent depleted. But it by no means follows that this surplus consisted of income. The court nowhere in its opinion so declares, and as it assimilates the case to *Lee v. Neuchatel Asphalte Co.*, the presumption would seem to be directly to the contrary. The surplus was composed of the same species of property as the dividends.

which made it up, and they, as we have seen, were mainly capital

The Pennsylvania cases of *Commonwealth v. Penn Gas Coal Co.*, 62 Pa. St. 241, and *Commonwealth v. Ocean Oil Co.*, 59 Pa. St. 61, are clearly distinguishable from the case now before the court. They arose under section 2 of the Pennsylvania Act of April 30, 1864, (P. L. No. 210, p. 218), which provides as follows:

> "That every private banker and broker, and every incorporated, and unincorporated, banking and saving institution, and deposit and trust company, every gas company, express company, bridge company, insurance company, foreign insurance company, building and land association, manufacturing, mechanical, *mining, and quarrying companies*, and all other companies, and corporations doing business in this commonwealth, except those specified in the first section of this act, *not paying a tax to the state upon dividends, under existing laws*, shall annually, upon the first day of November of each year, make report, to the auditor general, under oath, or affirmation, setting forth the amount of net earnings, or income, received by said individuals, or corporation, from all sources, during the preceding year, and *upon such net earnings, or income*, the said individuals, or corporation, as the case may be, shall pay to the treasurer, for the use of the state, within sixty days thereafter, three per centum upon such annual net earnings, or income, in addition to the taxes now imposed by existing laws."

This statute, it will be observed, expressly imposed a tax upon a number of corporations, some being ordinary mercantile corporations with permanent capital, like banks, and others corporations with wasting assets, like mining and quarrying companies. Such corporations, if "*not paying a tax to the state, upon dividends, under existing laws*," were required to pay a specified tax upon

"net earnings, or income." Manifestly, it was the aim of this act to tax mining corporations, and to tax them if they did not already pay a tax upon dividends. In pursuance of this policy of equalizing taxation, it was enacted that there should be a tax upon "*net earnings, or income*" imposed upon the mining and other corporations described in the act. To achieve the approximate equality aimed at by the statute, it was necessary to construe the words "net earnings, or income" to mean substantially the same thing as dividends, namely, that fund, which in the case of any particular corporation subject to this tax, was considered as earnings or income for the purpose of declaring a dividend, even though it might in fact consist of capital. In the case of a petroleum or mining company, therefore, the fund upon which the tax was incident was the fund available for dividend purposes. It constituted that fund "net earnings" within the meaning of the taxing act, but did not alter its true character. It was and it always remained capital, although, by force of a policy apparent upon the face of the statute, it was for one purpose to be regarded as "earnings." The Pennsylvania statute, however, is essentially different from the Federal Corporation Tax Law. The federal statute is not concerned with "net earnings," and contains no language suggesting that the "net income" which measures the tax, is to be regarded as being the same fund which provides dividends for the shareholders. Machen on The Federal Corporation Tax Law, sec. 13. Nothing of this sort appears in the act, and no such provision can be read into it without doing violence to the principle that taxing acts must be strictly construed and all reasonable doubts in respect thereto resolved in favor

of the citizen. *Mutual Benefit Life Ins. Co. v. Herold*, 198 Fed. 199, 201, aff'd. 201 Fed. 918, and *Parkview Bldg & Loan Assn. v. Herold*, 203 Fed. 876, 880 (involving the federal corporation tax).

The English Income Tax cases relied on by the government relate to statutes quite different from the one before the court, but even they serve to show that ore in place or its value is not income. *The King v. Attwood*, 6 B. & C. 277, decided in 1827, involved a tax imposed under the authority of 43 Elizabeth, c. 2, which empowered the churchwardens and overseers of the parish to raise money for the relief of the poor "by taxation of every inhabitant, parson, vicar, and other, and of every occupier of lands, houses, tithes, . . coal mines, or saleable underwoods in the said parish, in such competent sum and sums of money as they shall think fit." Clearly this was a tax upon the mine itself and not upon the income derived therefrom. By operation of custom, the annual value of the property was taken as the basis for the tax; and of course the annual value of a mine is what it produces during the year, what it will rent for, in other words, what it is worth to have the right to deplete its capital for a year. And that the court ruled was the proper amount to tax the mine owner. Chief Justice Abbott said (p. 282):

> "The owner and occupier of a coal mine, should be rated at such sum as it would let for, and no more . . . The legislature has expressly made coal mines rateable, and they must be rated for what they produce, viz., the coals."

It does not follow from anything in this decision that the value of ore in place is to be treated as income. The annual value of a mine is not the same thing as its annual

income. "Property may have an annual value without any income." *Troy Iron and Nail Company* v. *Corning*, 45 Barb. 231, 247; *Betts* v. *Betts*, 4 Abb. N. C. 317, 400. It is true that Lord Blackburn in *Coltness Iron Co.* v. *Black*, L. R. 6 App. Cas. 315, 330, spoke of statutes like the statute of Elizabeth as "very much in the nature of an income and property tax", and no doubt in so far as the statute of Elizabeth concerned the taxation of inhabitants, tithes, etc., it was "in the nature of an income tax," but in so far as it taxed mines, etc., it was, as his Lordship was careful to add, a "property tax."

It is sometimes asserted that the modern English Income Tax Act (5 & 6 Vict., c. 35; 16 & 17 Vict., c. 34) is a tax on income and on nothing else, and a *dictum* to that effect may be found in Lord Macnaghten's opinion in the case of *London County Council* v. *Attorney General* (1901) App. Cas. 26, 35. The statement is inaccurate, as will appear from an inspection of the act itself and from the authorities hereinafter referred to. The tax is imposed "for and in respect of the annual profits or gains arising or accruing to any person" (16 & 17 Vict., c. 34, sec. 1), and in most cases affects only income. But the act also provides (5 & 6 Vict., c. 35, sec. 100), sched. D, first case, rule third, that in estimating the tax in certain instances no deduction shall be allowed "on account of any capital withdrawn . . . , nor for any sum employed or intended to be employed as capital," nor (*id.*, sec. 159) "on account of diminution of capital." This clearly means that capital under the described circumstances shall be taxed as though it were "profits or gains" or income. For that reason, among others, it is not cor

rect to say that the English tax is exclusively upon income; and that may explain why Sir Francis Gore, K. C., Solicitor to the Internal Revenue, in his article in Lord Halsbury's "Laws of England" (vol. 16, p. 616) defines the tax as a "duty charged upon annual gains and profits in the nature of income." The federal tax, however, contains no clauses like those quoted above nor any language indicating an intention to tax capital under any circumstances. The fact, therefore, that the value of ore in place is subject to the English tax does not prove it to be an item of income or sustain the argument that it is subject to the federal tax. As a learned writer on the English tax declares in a book recently published (Jarvis on Income Tax, ed. 1912, p. 53):

> "Many cases might be mentioned in which capital is practically taxed as income. The above case of the working up of the earth at a particular spot into chemical substances and calling the whole produce profits and gains, although part of it is a return of capital invested [*Alianza Co. v. Bell*, discussed below], is not unique. The same happens in case of every mine owner. A man buys a colliery for say £100,000. It may produce £20,000 a year profit and that may continue for twenty years before it is exhausted. The mine owner is taxed upon the whole of the output each year, less of course expenses of working, as though it were clear profit. Part of it is undoubtedly so, as being the result of the work and labor expended and the expenses incurred in getting it, but the *quantum* by which the whole amount of the mineral is diminished is certainly capital, yet for its exhaustion no deduction is allowed notwithstanding the *dictum* that the tax is on income only and not on capital."

With these facts in mind we can arrive at a clearer understanding of the British decisions. In *Addie & Sons v. Solicitor of Internal Revenue*, 12 Sc. L. R. 274 (1875), a

firm of iron masters owned mineral fields and had erected buildings and sunk pits thereon. They claimed the right to deduct a certain sum, "being a percentage for pit sinking and for depreciation of buildings and machinery," from the amount upon which their tax was measured. The claim was disallowed, the Lord President saying (p. 275):

> "The making of a new pit in a trade of this kind is, in every sense of the term, just an expenditure of capital. It is an investment of money, of capital, and must be placed to capital account in any properly kept books applicable to such a concern. Now, if that be so, it seems to me that the provision of the 3d rule under the 1st head of section 100 of the Property Tax Act is conclusive upon the question before us, because it is there provided that in estimating the balance of profits and gains chargeable under schedule D, or for the purpose of assessing the duty thereon, no sum shall be set against or deducted from, or be allowed to be set against or deducted from, such profits or gains on account of any sum employed or intended to be employed as capital in such trade. It seems to me that it is quite unnecessary to go beyond that one part of the statute. No doubt some support may be had also from the 159th section (part of which provides that no deduction shall be allowed 'on account of diminution of capital'), but I think this rule is in itself perfectly conclusive. As soon as you ascertain that this is an expenditure of additional capital, there is an end to any proposal to deduct anything in respect of it."

Certainly there is nothing in this decision to suggest that the value of ore in place is income. If anything, the case intimates the contrary.

In the case of *Inland Revenue* v. *Farie*, 16 Sc. L. R. 189 (1878), a colliery owner asserted a right to a deduction in respect of capital lost through the partial exhaustion of his mine in the course of mining operations. He was

defeated. It was argued on his behalf that (p. 191) "when working a coal mine you were in selling coal parting with capital as well as, in most instances, making a profit; but before you could settle what the profit was, you must deduct a certain sum in respect of capital lost." To which the Lord President replied, "That is quite true in theory—the question is whether that is the meaning of the Income Tax Acts." So that his Lordship recognized that ore in place was, upon principle or theory, a capital asset, but refused to hold that it was on that account non-taxable in view of the specific provisions of the statute. This feature of the case received consideration in Lord Mure's opinion. He said (p. 193):

> "I shall only add that in the 3d rule of case I, section 100, there are expressions which show that it was in the contemplation of the Legislature that deductions of this sort should not be allowed, because this case comes substantially, in my opinion, within the meaning of the words in that section 'nor on account of any capital withdrawn therefrom.' The diminution from working out the subject is just a kind of withdrawing of capital; and it is so stated in the case, for it is said to be deduction for the partial exhaustion of the mine or diminution of the capital, and in section 159 of the statute the same expression is used, that deduction shall not be allowed 'on account of diminution of capital.' Now, having these provisions in the statute, and it being stated in the case that what is here claimed is in reality a diminution of the capital, I think that is an additional reason to those stated by your Lordship for holding that this claim ought not to be sustained."

Nor is there anything at variance with our views in *Coltness Iron Co. v. Black*, L. R. 6 App. Cas. 315 (1881). The facts involved in that case were similar to those which gave rise to the *Addie* case (*supra*), and the House of

Lords approved that decision and held that "a tenant of minerals, though he may be under a constant vanishing expense in sinking new pits as the old ones become exhausted, is not entitled, in computing the profits for assessments of income tax, to deduct from the gross profits a sum estimated as representing the amount of capital expended in making bores and sinking pits, which have been exhausted by the year's working" (syllabus). As the expenditure in making the bores and sinking the shafts was a capital expenditure, and such items were expressly forbidden to be deducted by the taxing act, the House of Lords was entirely correct in overruling the Iron Company's contention. But the case does not hold that the value of ore in place is an item of income. By section 60, sched. A, rule 3, it is directed that mines are to be taxed upon their annual value. This is the measure which for a long time before had been applicable to mines under parochial taxation, and, as we have seen in discussing the *Attwood* case (*supra*), that measure subjected to taxation, not merely income, but capital as well. Lord Blackburn declared (p. 336) that it had been "the constant course from the Statute of Elizabeth downward to construe an annual tax imposed on coal mines, quarries, and the like, as being imposed on that which is produced from them," and that fact, together with the manner in which mines were treated in enactments like 43 Geo. 3, c. 122, persuaded him that this method of taxing mines was preserved in the act of 5 & 6 Vict., c. 35. In other words, he recognized that it was capital which was being taxed when the duty was imposed upon the product of a mine without making any allowance for the depletion of the ore.

Moreover, that ore in place constitutes capital and not income and is taxable under the English Act only because of its peculiar provisions, to which section 38 of our Tariff Act of 1909 affords no analogy, will become apparent if we consider the case of *Alianza Co. v. Bell*, (1906) App. Cas. 18. A British company owned a nitrate bed in Chile. It dug out the crude chemical deposit and manufactured it into the finished product. Of course, the process steadily decreased the supply of mineral, and hence diminished its capital. The company sought a deduction on that account, but the courts denied it relief, the ground of the decision in all the courts being that the act expressly forbade an allowance on account of such a loss of capital. Thus, Mr. Justice Channell said ([1904] 2 K. B. 673):

> "The question in this case which we have to consider is what is the nature of the adventure or concern which this particular company is carrying on. If it is merely a manufacturing business, then the procuring of the raw material would not be a capital expenditure. But if it is like the working of a particular mine or bed of brick earth, and converting the stuff worked into a marketable commodity, then the money paid for the prime cost of the stuff so dealt with is just as much capital as the money sunk in machinery or buildings. In my opinion the particular adventure here belongs to the latter category. This company must be treated as a company formed for the purpose of working and developing the bed of caliche. . . . Consequently the money sunk in purchasing this bed is a capital and not a current expenditure. Then, if it is a capital expenditure, no allowance can be made in respect of it in estimating the profits. The third rule of the First Case provides that there shall be no deduction 'for any sum employed or intended to be employed as capital in such trade, manufacture, adventure, or concern.'"

In the Court of Appeal the same view was adopted ([1905] 1 K. B. 190, 195), and the House of Lords distinctly affirmed the decision of the Court of Appeal upon the same theory. Lord Macnaghten said ([1906] App. Cas. 19): "It appears to me that this claim is prohibited by the third rule, being a claim in respect of money employed as capital." Lord Robertson declared that (p. 19):

> "It is under Sched. D that the case is to be judged. Then, is this capital which he proposes to obtain a deduction for? That seems to me to be entirely concluded by the facts of the case. There is no doubt whatever that the scheme of the enterprise of this company was to invest their capital in the acquisition of this property and then to proceed to work it as a mining concern. . . . The whole of the argument of Mr. Danckwerts is really founded upon what I suppose no one would doubt, that as the output takes place there is a consumption of a certain proportionate amount of the capital; but that is concluded, as my noble and learned friend on the woolsack has said, by r. 3.
>
> "Further I agree with Stirling, L. J., that s. 159 is never to be laid out of account in these instances, because in its express prohibition of an allowance being made for capital, it on the face of it refers to all the various cases under the various schedules. Accordingly, the argument that there is something peculiar to Sched. A in the principle which has been applied in the cases which have been mentioned fails before the universal conspectus which in express terms is given by s. 159 to this very principle."

And Lord Lindley added (p. 20): "I am entirely of the same opinion. It appears to me it is quite impossible to get out of r. 3."

Forder v. *Handyside*, L. R. 1 Ex. D. 233 (1876); *Gillatt & Watts* v. *Colquhoun*, 33 W. R. 258 (1885); *Smith* v. *Westinghouse Brake Co., Ltd.*, 4 Times L. R. 649 (1888); *Edinburgh Southern Cemetery Co.* v. *Solicitor of*

Internal Revenue, 27 Sc. L. R. 71 (1889), and *Morant* v. *Wheal Grenville Mining Co.*, 71 L. T. Rep. 758 (1894), illustrate the same principle. In all of them it is recognized that the wasting assets consumed in the progress of the business constitute capital, and that such assets are affected by the taxing act only because it is therein expressly commanded that this species of capital shall be taxed.

It must be noted that the *ratio decidendi* of all the cases under the English Income Tax Act hereinbefore referred to, is the peculiar language of that Act. By section 159 thereof any other deductions than those provided for in the act itself are forbidden. By rule 3 of section 100, in all cases relating to schedule D, it is provided that no deduction shall be allowed on account of capital withdrawn or on account of any sums employed as capital. Consequently, in no instance falling under schedule D may the value of ore in place, though confessedly an item of capital, be freed of the tax. Finally, in section 159 there is a prohibition against the allowance of any sum "on account of diminution of capital," and that prohibition, as Lord Robertson held in *Alianza Co.* v. *Bell* (*supra*), "refers to all the various cases under the various schedules," and, therefore, constitutes in Great Britain a universal bar to any deduction in any case on account of the exhaustion of capital consequent upon mining operations.

But one will look in vain for similar provisions in section 38 of our Act of 1909. The federal tax falls solely upon net income; it has nothing to do with capital in any form. It is not levied upon anything that consists of

capital, nor does it inhibit the deduction of any amount or kind of capital. If Congress had intended to reach such capital as is represented by ore in place in a mine, it need only have adopted the provisions of the English act, with which it was presumably familiar. But Congress deliberately omitted from its enactment the prohibitions which in England accomplish the taxation of this variety of mining capital, and that fact, it is submitted, leaves open no inference but that Congress did not intend to tax the value of ore in mines.

II.

THE VALUE IN PLACE OF ORE THAT HAS BEEN EXTRACTED FROM A MINING PROPERTY DURING A GIVEN YEAR IS A PROPER DEPRECIATION CHARGE TO BE ALLOWED IN COMPUTING THE TAX DUE UNDER SECTION 38 OF THE ACT OF CONGRESS APPROVED AUGUST 5, 1909.

Section 38 provides that the taxable net income "shall be ascertained by deducting from the gross amount of the income" various items, and among them the following:

> "All losses actually sustained within the year and not compensated by insurance or otherwise, *including a reasonable allowance for depreciation of property, if any.*"

Assuming, for the purpose of argument, that the value of ore in place is not an item of capital, and must therefore be included in the statement of gross income, this item ought then to be deducted because it constitutes a depreciation of the property. It is manifest that the working of a mine necessitates the consumption of the ore contained therein and operates to that extent to deplete and depreciate it. Every day's operations bring nearer

the time when the ore deposits will be completely exhausted and, therefore, every day and every year of the working of the mine witness a *pro tanto* decrease in the value of the mine, and hence a depreciation. It is no answer to this contention to say that the mining operations may in fact result in exposing new ore deposits and thus accomplish an appreciation instead of a depreciation in the value of the mine. Such an event may change men's opinions concerning a particular mine, but it cannot change the absolute fact that every day's operations do in reality work a certain degree of depletion of the actual capital of the mine.

That an allowance in computing the tax should be made on account of this species of depreciation, has been recognized by the executive department of the government (T. D. 1571 [Dec. 3, 1909], art. 4; T. D. 1606 [Mar. 29, 1910], pars. 72, 75; T. D. 1742 [Dec. 15, 1911], par. 97), and in the case of *United States* v. *Nipissing Mines Co.*,* 202 Fed. 803, 804, effect was given to the principle here contended for. Circuit Judge Lacombe, in directing a verdict against the government, there used the following language:

> "This statute provides for a deduction of all losses actually sustained within the year, including reasonable allowances for depreciation of property, if any. . . .
>
> "The testimony here seems to me entirely reasonable, and certainly it is not contradicted, that the value of the ore as it lies in the ore beds is as stated by the witness to be 31.1 cents. . . . This unit of value, 31.1 cents, multiplied by the total amount of ore that was removed during the year, indicates in dollars the amount by which the total assets of this company were depleted through the operation of the

*Disposed of on other grounds on appeal, 206 Fed. 431.

mine during the year. It seems to me to be a reasonable allowance for depreciation within the meaning of the statute. Certainly so much value has been eliminated from the property of the company forever. . . .

"If the known value of an ore bed were exactly \$2,000,000, and exactly \$500,000 were taken out of it each year, in four years there would be nothing left. It is difficult to say why it may not reasonably be said that the ore bed suffers each year a depreciation of \$500,000, just as a \$10,000 piece of machinery with a life of ten years suffers a depreciation of \$1,000 each year. As I read the statute, Congress intended to allow all reasonable depreciations to be deducted from the gross profits to find the net; and the reasonableness of any deduction asked for depends upon the nature of the claim on which it is based, not upon the amount of dollars it may aggregate. Nor is it apparent why it should make any difference that one cannot tell with reasonable certainty the total value of the deposit, so long as the value of the amount removed in any one year can be ascertained with sufficient accuracy. Nor is it apparent why the problem is altered in any way by the circumstance that the property was bought at a very high or a very low price, or that the capitalization of the company which owns it is large or small."

Similar views are expressed by Mr. Machen in his learned treatise on The Federal Corporation Tax Law (secs. 53, 57). Speaking of the clause of the statute quoted above, he says:

"This is a very important class of the prescribed deductions; for it is possible that if deductions of this class had not been specifically directed some of them at least would have been held not proper to be allowed in calculating net income. For example, depreciation of fixed property may be disregarded in calculating profits for the purpose of dividends; and it is quite possible that the courts might have held that it should be disregarded in calculating net profits

for the purpose of this tax, if the law had not expressly declared to the contrary [citing *Alianza Co.* v. *Bell*, (1906) A. C. 18; *Coltness Iron Co.* v. *Black*, 6 A. C. 315; *Forder* v. *Handyside*, 1 Ex. D. 233, and *Little Miami, etc., R.R. Co.* v. *United States*, 108 U. S. 277]....

"The provision as to depreciation of property . . . evidently covers depreciation of all kinds—by wear and tear, by diminution in value of wasting assets, such as mines, leases or patents, or in consequence of supersession by improved apparatus, and in fact diminution in value of all kinds. But for this express provision, it might have been plausibly argued, and perhaps would have been held, that a depreciation in the value of a company's fixed capital does not in any way diminish the net income. This [last] is true under the English Income Tax Laws: *Gillatt* v. *Colquhoun*, 33 W. R. 258; *Coltness Iron Co.* v. *Black*, 6 A. C. 315; *Alianza Co.* v. *Bell*, (1906) A. C. 18; *Forder* v. *Handyside*, 1 Ex. D. 233."

Moreover, in the very recent Income Tax legislation Congress has specifically recognized the justice of the principle herein contended for, but has limited its application, by particularly providing for a deduction "in the case of mines [of] a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation [of taxable income] is made."

In none of the Pennsylvania or British decisions is there anything inconsistent with the contention in favor of the allowance of this kind of depreciation. The Pennsylvania statute contains no provision for the allowance of any deduction for depreciation, while the Act of Congress of August 5, 1909, is quite explicit upon this score, and the differences between the English and federal statutes serve to distinguish the cases decided in the United Kingdom.

Section 159 of the English act declares that "it shall not be lawful to make any deductions [other] than such as are expressly enumerated in this act," and prior to 1878 no deduction for depreciation of any kind was provided for in the act. Accordingly, in *Forder* v. *Handyside*, L. R. 1 Ex. D. 233, decided in 1876, a claim for the annual wear and tear of machinery and plant was denied. It was to meet this deficiency in the law, then exposed, that section 12 of the Customs and Inland Revenue Act of 1878 (41 & 42 Vict., c. 15) was enacted. It provided in part as follows:

> "Notwithstanding any provision to the contrary contained in any act relating to income tax, the Commissioners . . . shall, in assessing the profits or gains of any trade, manufacture, adventure or concern in the nature of trade, chargeable under Schedule D, or the profits of any concern chargeable by reference to the rules of that schedule, allow such deduction as they may think just and reasonable as representing the diminished value by reason of wear and tear during the year of any machinery or plant used for the purposes of the concern, and belonging to the person or company by whom the concern is carried on."

This statute is precisely commensurate with the doctrine of the *Forder* case, which it abrogates, and it applies to cases of no other kind. That was distinctly ruled in *Gillatt & Watts* v. *Colquhoun*, 33 W. R. 258, 261 (1885), where A. L. Smith, J., referring to *Forder* v. *Handyside* and to the legislation consequent upon that decision, said that Parliament had now "allowed depreciation of machinery to be brought into the balance sheet made out by traders under schedule D, but [had] left everything [else] standing as it was before as regards depreciation."

Of course, the provision allowing a deduction for wear and tear of plant and machinery was not broad enough to

cover depreciation due to the depletion of ore deposits in mines, nor the depreciation in mining shafts caused by the fact that the cost of such shafts becomes a total loss when the ore to be reached through them gives out. In such cases, the English law remained as it had been before the act of 1878, and no deduction for depreciation of this sort could be had, because the provisions of section 159 of the Income Tax Law forbade it. That explains why no claim for this species of depreciation was recognized in *Inland Revenue* v. *Farie*, 16 Sc. L. R. 189 (1878); *Coltness Iron Co.* v. *Black*, L. R. 6 App. Cas. 315 (1881), and *Alianza Co.* v. *Bell*, (1906) App. Cas. 18. Counsel for the assessor of taxes advanced this construction of the statutes in his argument in *Coltness Iron Co.* v. *Black*, L. R. 6 App. Cas. at p. 322, and Mr. Justice Channell distinctly relied upon it in the *Alianza Company* case, (1904) 2 K. B. at p. 674, where he spoke as follows:

> "Even in the very clear case of depreciation of machinery used in trade under the original Acts no deduction could be made; and the fact that it has now been specially provided for by statute rather emphasizes than otherwise the general principle of the Acts that the provision for wasting capital by means of a sinking fund cannot be allowed for in the computation of profits and gains."

If Congress intended by its enactment of section 38 of the Tariff Act to permit a deduction on account of depreciation no larger than that allowed in England, it could have adopted the provisions of the English statute and it could, as is done therein, have provided only for the wear and tear of machinery and plant and have forbidden, as section 159 of the English tax law does, any further

deduction. But Congress, presumably cognizant of the English law, did not choose to pursue that course. It did not see fit thus to limit the allowance for depreciation. It employed the broad term depreciation, and that term adequately and naturally describes the depletion of ore deposits and the declining value of mining shafts as mining operations proceed. There is nothing in the federal act which in any manner limits or qualifies the meaning of this term, and the courts cannot do so by interpretation.

CONCLUSION.

It is, therefore, submitted (1) that ore in mines owned and operated by mining corporations is capital and not income, and (2) that the diminution of ore deposits and wasting of mining shafts are depreciation charges and as such properly an item of deduction from the amount to be taxed, within the plain words of the statute.

New York, October 11, 1913.

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